Président : Jean-Pierre LANDAU,
Rapporteur général : Bertrand BADRÉ, Inspecteur des Finances
Rapporteurs : Corso BAVAGNOLI, Inspecteur des Finances,
Gilles MENTRE, Inspecteur des Finances.
project director : Madeline REY

****

- Sir Tony ATKINSON, Warden, Nuffield College, Oxford University
- M. Robert BACONNIER, Président du Bureau Francis LEFÈVRE
- M. Jacques COSSART, Membre du Conseil Scientifique d'ATTAC
- M. Michel DIDIER, Président de REXECODE
- M. Fleming LARSEN, IMF, head of European office, Paris
- Mme Anne LAUVERGEON, Présidente d'AREVA
- M. Alain LE ROY, Directeur des Affaires économiques et Financières, Ministère des Affaires Etrangères
- Mme Elisabeth LULIN, Directeur Général de Paradigmes, Administrateur de la Société Générale
- M. Vincent MAZAURIC, Sous-Directeur, Direction de la Législation Fiscale, Ministère de l'Economie, des Finances et de l'Industrie
- Mme Odile RENAUD-BASSO, Chef du Service des Affaires Internationales, Direction du Trésor, Ministère de l'Economie, des Finances et de l'Industrie
- M. Henri ROUILLÉ D'ORFEUIL, Président de Coordination Sud
- M. Jean-Michel SEVERINO, Directeur général de l'Agence Française du Développement.
- M. Yves-Thibault de SILGUY, Délégué Général de SUEZ
- M. Kevin WATKINS, Head of Research, OXFAM

EXECUTIVE SUMMARY

This report was commissioned in November 2003 by President Chirac to a group of independent personalities with different backgrounds and representing a wide range of opinions. Members of the group participated in their personal capacity. The views expressed do not reflect those of the institutions, organizations or companies to which they belong. While none of the group members disagrees with the general thrust and approach of the report, none would, either, fully support or endorse each and every specific reflection or recommendation.

Globalization creates tremendous prosperity. There are strong moral and social justifications to allocate part of that wealth to the fight against poverty and inequality.

Yet this moral and political imperative does not translate easily nor automatically into new financial contributions. The idea itself is very controversial, at least in its most extreme manifestation, that of international taxation.

The legitimacy of international taxation is open to question. There is no such thing as a world parliament to decide and vote on global taxes. >From a democratic and legal standpoint, new contributions would require the consent of nation sates and by extension, of their citizens. Such consent does not exist today. On the contrary, opposition runs deep in many countries to the principle of international taxation. Motivating the opposition is the fact that national sovereignty is viewed as untouchable, especially in matters of taxation.

There is also much skepticism, in some countries or parts of world opinion, as to the benefits of development aid. This report does not share that skepticism. Ultimately, all developing countries, including the poorest ones, must aim at achieving -through economic growth-successful integration into the world economy. But growth is impossible without a minimum level of infrastructure and income, and access to health and education. Otherwise, there is no capital accumulation and the poor are left exposed to economic shocks they are not equipped to withstand. Growth is necessary for poverty reduction. But poverty itself may be an obstacle to growth. Aid therefore becomes absolutely necessary to break this reciprocal

causality.

Finally, even some of the most sincere and committed people in the development community have their doubts, wondering whether greater priority should be given to increasing national aid budgets to 0.7% of GDP (an objective to which France is committed). They tend to see the search for innovative mechanisms as a diversion, or escape route used by developed countries to avoid fulfilling their obligations and meeting their commitments.

This is a legitimate concern, and is addressed in the first part of the report. It shows why and how new contributions are necessary together with and in addition to existing forms of development aid. Potential economic, legal and financial approaches to an international taxation for development are discussed in the second part. Finally, some technical options for voluntary or compulsory contributions are examined in the third part.

More and better funding for development

It is well known that official aid would have to double, increasing by at least $50 billion a year, in order to achieve the Millennium Development Goals (MDGs). What is less known is that: less than $3 billion a year for 10 years would be sufficient to give every single child in Sub Saharan Africa access to primary education; $2bn annually would finance basic medical research on those pandemics (AIDS, tuberculosis, malaria) specifically affecting developing countries; and with $1 billion a year one could provide the resources needed to perform the ten basic surgical procedures needed all over the world.

These are very small amounts of money when measured on a global scale. And these are priorities that nobody would challenge. Yet, the financing fails to materialize.

This is difficult to explain by a decline in the generosity and altruism in developed countries. Official Development Aid (ODA), which had been decreasing for most of the last decade, has recently picked up and is on an increasing trend. Private foundations, whose interventions were traditionally domestic-oriented, are now diversifying and increasingly supporting international causes.

One therefore has to conclude that the problem is systemic. The procedures for deciding and allocating aid flows are based on permanent negotiations between donors whose strategies change according to their priorities, their (legitimate) foreign and development policy objectives, and whose budgets are decided, for the most part, on an annual basis.

Such a process is bound to produce sub-optimal results:

- *Insufficient resources* because each donor has built-in incentives to finance its own priorities first, and then to free ride on other countries contributions to finance common objectives

- *High negotiation and transaction costs*, both for donors (in time and resources spent in reaching compromises) and recipients (who find it increasingly difficult to grapple with the system's complexity and uncertainties)

- *Aid is inadequate and inappropriate in form*; only one third of disbursements currently go to fighting poverty; grants are insufficient; less than 50% of aid actually translates into cash transfers to developing countries.

- *Aid is both volatile* (four times more volatile on average than recipients' GDP) *and unpredictable*. Far from helping countries to cushion economic shocks, it is often an additional source of instability.

What is necessary then is continuity in donors commitments over the long run: first, because human development and the fight against poverty are mainly based on recurrent expenditures in basic social services; and second, in order to ensure adequate financing for those public goods especially necessary to poor countries such as medical research on pandemics which particularly affect developing countries.

One crucial element is currently missing in the present development system: a resource that is both totally concessional and predictable. In order to produce such a resource, new multilateral (and more automatic) financing mechanisms are necessary.

New international financial contributions

One such mechanism would be the International Finance Facility (IFF), which has been

proposed by the British government and is supported by France. The objective is to frontload the disbursement of expected future increases in ODA. The IFF would issue bonds on financial markets, backed by pledges from participating governments. It would produce a stable resource, whose availability would not be dependent on the time schedule of donors' budgetary contributions. It would be flexible and could be implemented, if necessary, on a regional basis or with a limited number of participating countries. However, as with any borrowing mechanism, the final burden would be shouldered by future generations, with no guarantee as to the return on expenditures that would be financed this way. There is thus a central question regarding what happens after 2015, when a significant part of ODA expenditures, in developed countries, would be devoted to IFF repayments rather than being transferred to developing countries. And yet, many such countries, especially in Sub Saharan Africa, will still need aid. For those countries, frontloading aid entails a significant risk if, in the meantime, other stable sources of finance have not been created.

Another possible mechanism is international taxation.

International taxation can only result from a decision by nation states to cooperate, since they – and only they- have the power to tax. It means that this power, which is a basic attribute of sovereignty, is subordinated to an international common objective. This can only be achieved when there is a high degree of convergence between those objectives. International taxation may therefore prove difficult to negotiate and agree upon.

Once created however, it would deliver the precise kind of resource needed to finance human development, one that is both totally predictable and concessional. It would put the financing of poverty reduction on a sound and stable basis and would protect it from the vagaries of politics and the uncertainties of international cooperation. It would ensure stable and predictable aid flows, even in the long run. It would dispense from the difficult yearly negotiations and would solve, once and for all, the burden sharing problem. Finally, it would not increase the financial burden on future generations.

Contrary to widespread perception, no new institutional arrangement or international organization is necessary. International taxes can be created for a limited period of time. They can initially aim at financing only core programs, those that need stable and predictable resources most. Even small amounts, at the start, would make a difference by increasing the return on other aid flows and creating an environment, which would increase their overall

efficiency.

The IFF and international taxes have strong complementarities: one mechanism or the other may be more appropriate according to the time horizon or the type of expenditure. They can be combined in an integrated approach to human development finance, encompassing both the medium and long run.

Consequences for the development aid system

Once a predictable and concessional resource is created, three issues would have to be addressed:

- Additionnality. New resources would have to be truly additional and not simply substitute existing aid flows. It may be necessary to establish a more direct and visible link between the new sources of finance and the programs to which they are allocated. One question to be considered is how to organize and manage financial channels so as to make this kind of earmarking compatible with good fiscal management

- Conditionality. It is a condition for efficiency. It may also be a source of excessive volatility when resulting from changes in donors' priorities and preferences. Forms of conditionality adapted to a stable financing of human development would have to be defined and devised.

- Governance. The management of any new stable resource would have to be discussed in order to define the role and interaction of all potential participants : IFIs, global funds and civil society (NGOs and private sector)

Options for an international tax system

Efficiency, justice and equity

All tax systems are based on a trade-off between efficiency and equity. Similarly, international taxes could be created with different objectives such as: correcting international externalities (as with environmental taxes); moralizing international transactions (which would be the purpose of a tax on arms sales); redistributing income and reducing inequalities (something that all national tax systems do to varying degrees); and finally, financing public

expenditures decided with a common purpose.

Here, the report makes choices and defines priorities. At this stage, the aim of international taxation should be to raise the necessary resources in order to achieve the MDGs. At the world level, there is no democratic process to determine what the extent of income redistribution should be. But there is a universally accepted goal in terms of poverty reduction. The international community has decided to focus on the situation of the poorest people, not on the gap between different levels of income around the world. This approach is based on well-established philosophical and ethical premises and best legitimizes international taxation.

International taxes should therefore be devised first and foremost according to their financing potential.

Once this priority is met, however, other objectives can and should be pursued.
First, economic efficiency. International taxes can improve development financing by reducing the distortions normally associated with any taxation. Corrective taxes, such as environmental taxes, do not create any new economic distortions, and actually eliminate some. Equally, taxes levied at a very low rate on internationally mobile tax bases may be less distortionary than an increase in national taxes, whose rates are already much higher. In both cases, however, it may be impossible to create such taxes without strong international cooperation.
Second, solidarity. New international contributions would encompass a broader aspiration of greater global stability, more security and more justice in global development. They should not result in new burdens or handicaps for poor countries. New contributions should never be regressive but rather neutral or progressive.

Architecture

Once the decision is made to finance development through more automatic mechanisms, several options are available to the participating countries. They can be combined into a wide array of different formulas:

- The mechanism can be legally binding to a greater or lesser extent. It could be: a simple statement of intentions to contribute according to specified criteria; a system of contributions akin to those made to international organizations, paid out of national budgets with countries, in effect "taxing themselves" (a tax on arms would be very

close to such a scheme, with countries contributing in proportion to their military expenditures)

- Financial flows could transit through national budgets where they would be treated either as expenditures (as VAT contributions by member states to the EU budget) or a deduction on receipts (as own resource contributions to the EC budget). Alternatively, as was the case for ECSC and still is for the Universal Postal Union, financial flows could bypass national budgets and go directly to the recipient institution.

- Above all, choices would have to be made as to the underlying political and fiscal approach. Several such approaches are described in the report:

    - Enhancing voluntary contributions through tax incentives in a coordinated way across donor countries;
    - Contributions in addition to existing taxes (which would replicate a GDP based contribution, as corrected by existing differences in tax bases);
    - Creating new international taxes levied, either on internationally mobile tax bases (which cannot be taxed by any country acting on its own), or on "global common goods" whose value cannot legally or practically be appropriated by any individual nation (global environmental taxes can be included in this category).

Global or regional tax?

Universal consensus on international taxation might prove difficult to achieve in the immediate future. Is there then, a possibility to create regional taxes? This question is especially important for those who would like to see the European Union expanding its role in development assistance. There would be obvious adverse consequences for the competitiveness of participating countries and important risks of evasion. But it might be useful to start a process, which could later lead to broader acceptance and participation. Both sides of the argument can be made with equal force. Clearly, some taxes would be more easily applicable in a regional framework than others. Countries that would decide to implement such regional taxes should also ensure (in the allocation and management of the resources) that sufficient incentives exist for others to join in.

Orientations

Possible contribution instruments and mechanisms are described and discussed in the final chapter of the report. They have been selected according to a common set of characteristics: all are technically feasible; all yield significant, stable and permanent resources to finance the MDGs; all are economically rational since they have been constructed so as to minimize new distortions, or eliminate existing ones; none (except an arms tax) would be levied on developing countries; none could be made to work without strong international cooperation (thus providing a justification for allocating their proceeds to development).

Instruments discussed include:

- Environmental taxes. Long-term prospects for a carbon tax are examined. In the short run, it is suggested to focus the reflection and debate on sectors not covered by the Kyoto Protocol and currently not subject to taxation, such as maritime and air transport.

- Taxes on financial transactions (with a special case on foreign exchange transaction taxes). They are not considered in the report for their anti-speculative properties but purely as revenue raising instruments. Consequently, the rates would be set very low so as to minimize or eliminate any adverse impact on market efficiency. The report concludes that (1) such taxes are technically feasible; (2) their "economic cost" is limited (3) all major financial centers should participate in order to avoid large scale evasion (but not necessarily every single country in the world) (4) market making and very short term transactions would have to be exempted since they carry very low profit margins and could not bear the burden of any tax; and, as a consequence (5) revenues raised would be significantly lower than currently expected, but nevertheless quite significant.

- a surtax on the profits of multinationals could be seen as a normal counterpart to the benefits they derive from globalization (although inter-country differences in the definition of tax bases would make such a contribution rather arbitrary in terms of burden sharing)

- A tax on arms would have to be levied on all purchases -whether domestic or international – and implemented by all producing countries in the world to be morally significant and economically non-distortionary.

- Voluntary contribution schemes could be proposed or encouraged by associating voluntary donations with credit card purchases, utility bill payments or when filing tax returns. Such schemes might be more appropriate than taxes when addressing households, even if they do not deliver as stable a resource as other contribution forms.

- Finally, the use of Special Drawing Rights (SDRs) and the creation of a Global Lottery for development purposes are examined.

Conclusion

Overall, the report concludes that there is a gap in the financing of MDGs; that the search for innovative forms of financing is justified, in a spirit of solidarity; and that technical solutions are available which combine moral generosity and economic efficiency.

It was not in the group's remit to choose between different possible solutions. The report does not make any specific recommendation. But some principles, which could help make progress on the political front, are enumerated in the conclusion. New financial contributions, if created, must find in themselves their own justification and meet with maximum acceptance.

This means:

- Universal consensus on goals, which should be seen as absolutely legitimate by the whole international community;

- Programs with high visibility, and whose impact must be proven and easily measurable;

- Economic efficiency, which leads to either corrective taxes or taxes at very low rates and broad bases;

- Equity in burden sharing;

- Total transparency in governance and management, both from the point of view of recipients and the international community.

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FOREWORD

The working group held twelve plenary meetings between November 2003 and July 2004. It held 19 formal hearings and 64 working meetings between the rapporteurs and outside personalities.

The report was discussed at length within the working group. All members expressed their views, each of them sitting and speaking in their personal capacity, independently of the organization to which they belong.

The Chairman and rapporteurs wish to express their gratitude to Professor Atkinson for allowing them access to the preliminary versions of the studies undertaken, under his direction, at the United Nations University WIDER Institute.

INTRODUCTION

A multidisciplinary working group on new international financial contributions was set up by President Chirac.

This report summarizes the findings of the working group. It is the outcome of the discussions and reflections of people drawn from a wide range of backgrounds.

It would be fair to say that, at the outset, the group did not view the creation of new international financial contributions as a foregone conclusion. Indeed, the idea itself is highly controversial, at least in its most advanced form, that of a full-scale international system of taxation.

There are certainly deep-seated ethical, social and economic justifications. Globalization creates a great deal of wealth. Opinions may differ over its distribution; but the process under way for the past thirty years has brought a level of prosperity for billions of individuals and has been accompanied by a reduction, at least in relative terms, in extreme poverty throughout the world. Nevertheless, more than 1.2 billion people still live on less than 1 dollar a day; the major pandemics are spreading in the developing countries; and the planet's environment is under threat. These challenges and risks are common to humanity as a whole. There is a case to be made for using a fraction of the wealth generated by globalization to meet these challenges and mitigate those risks.

There is however, no legal and institutional infrastructure for translating these justifications into a collective political will. No global Parliament exists to vote on a global tax. The legitimacy of new contributions would therefore depend on the consent of nation states and, beyond them, that of their citizens. No such consent exists, at present. The creation of an international tax would entail handing over some degree of sovereignty, which most countries are not willing to do, even in a limited form. So great is the opposition in the United

States that a law was passed in 1997 prohibiting any contribution to an international organization advocating an international tax levied on US citizens or corporations. Even the members of the European Union, which have achieved an unprecedented degree of economic and political integration, are still a long way from creating a common tax system. Plans for a European tax are stalled at present. This is another example of the difficulty to reconcile national sovereignty with the need for international cooperation.

There is no rationale for pooling financial resources if countries do not share common objectives. But such objectives do exist for development and poverty alleviation. In an unprecedented move in September 2000, the international community agreed a set of quantified poverty reduction and human development targets. These "Millennium Development Goals" (MDGs) are to be achieved by 2015. They were adopted unanimously by the United Nations General Assembly. Among the objectives, there are targets for halving extreme poverty (defined as 1 dollar per person per day), access to education, health improvement (reducing child and maternal mortality, combating major infectious diseases, especially HIV/AIDS and malaria), and providing sanitation and safe drinking water.

With current available resources, however, these goals cannot be achieved. The need for a radical change in scale in official financial transfers to poor countries is widely recognized. The most cautious estimates call for a virtual doubling of current official development assistance, i.e. additional transfers of USD 50 billion a year. To ensure that the MDGs do not end up as yet another noble declaration, soon to be forgotten, it is absolutely necessary to consider how they can be achieved and financed. There are political obstacles and constraints. Nevertheless, this report aims to looks at the possibilities for innovative sources and new international financial contributions as well as discussing their implications for the architecture of the development aid system.

PART ONE: MORE AND BETTER FUNDING FOR DEVELOPMENT

It is a shocking paradox that the resources required to achieve the MDGs are relatively small, less than 0.2% of global GNP, as compared to the wealth created annually by world growth. And yet they fail to materialize.

There are three possible reasons for this shortcoming:

- Skepticism: government and their citizens are not convinced of the necessity and utility of aid;
- Indifference: the fight against poverty and for development is not seen as a priority in relation to other causes;
- The current functioning of the international development aid system, which the group considers to be the main cause behind the lack of resources.

A need for more and different aid

The need for official development assistance is still viewed, in some countries and parts of world opinion, with a high degree of skepticism. According to this school of thought, the Millennium Goals can best be achieved through economic growth and free trade. Poor countries should essentially implement sound policies and create a favorable environment for private investment.

This report takes a different view: poor countries need aid in order to reap the full benefits of economic growth and the expansion of global trade. Furthermore, it makes the case that a change in the form and quality of aid is necessary in order to adequately finance human development.

Growth, trade, and poverty

Economic growth is critical to poverty reduction. One additional percentage point of per capita GNP growth reduces the percentage of poor people in the population by two points. Over the past fifteen years, many countries, including some with the largest populations, have made great progress in reducing poverty, thanks to vigorous economic growth.

Thus, any development strategy should bring all countries to a situation from which they can pursue this same path. Through the Millennium Development Goals, the final objective is to create the conditions for strong economic growth, enabling those countries to catch up with the most advanced economies, and fully reap the benefits of global economic integration.

International trade is a powerful driver of development. All the major experiences of economic take-off in the past fifty years have been export-led. No country has emerged from underdevelopment without entering the world market and using exports as en engine for growth. In terms of efficiency, international trade holds out immense potential for the poor. The expansion of world trade since 1970 has lifted more than 400 million people out of poverty. A 5% increase in developing countries' market share would generate revenues of 350 billion dollars, which is seven times current total official development assistance. Trade directly generates income, jobs, and investment.

Nonetheless, there are many obstacles, which prevent poor countries from exploiting these opportunities. First, there are physical obstacles and geographic handicaps: poor countries are frequently landlocked and suffer from recurring natural calamities, lack of infrastructure and poorly organized transportation systems. Unless these very real impediments to development are eliminated, trade liberalization will have little or no impact[1].

A second obstacle is economic dependence. Nearly one billion people depend on the production of commodities and staple products for their subsistence. This dependence is especially widespread in Africa. The poorest countries and their producers are the most exposed to price shocks, which can penalize or prevent economic growth if they are frequent. It is impossible to break this combination of extreme poverty and total dependence on commodity markets without external help or support.

Finally, and above all, poverty itself is an obstacle to growth. A considerable body of

research in recent years has highlighted the complexity of the mechanisms and linkages that keep more than 2 billion people below the threshold of 2 dollars per person, per day. It is now well understood that poverty is not defined in terms of income alone. It is a condition of extreme vulnerability caused by an absence of physical, financial and human "capital"[2]. Poor households and producers are consequently unable to withstand the shocks that naturally affect all market-based economies. They cannot afford to take risks, and therefore do not respond "normally" to economic incentives. This is the reason why the very poor are in no position to benefit from the opportunities created, fro instance, by market liberalization. [3]

As a consequence, there are thresholds of geographic isolation, health, education and vulnerability to natural disaster below which all economic progress is impossible.

The role of aid is to help countries to break out of this poverty trap when their domestic resources are insufficient. Human development and economic growth are mutually dependent. It is essential for countries to achieve sufficient levels of physical infrastructure and human development, particularly in terms of health and education. Those parameters determine a country's capacity to attract and stimulate investment, including private investment, without which sustained growth is impossible.

The need for aid is increasingly acknowledged, including outside the public sphere[4], as illustrated by the recent trends in private foundations activities, especially those located in the United States.

Those foundations are totally independent. As they are sustained by their endowments, they are immune to political pressures and the constraints of having to raise funds. Their funding structure allows them to undertake very long-term multiyear programs, something not generally possible with official assistance. Also, they are freer to take risks, innovate and experiment. The change in their attitude is significant of a growing awareness of the importance of development aid.

Until the last decade, development, and more generally international action, absorbed only a very small proportion (5%) of these foundations' disbursements. But the trend has now turned sharply upward and today 11% of their total outlays benefit developing countries[5]. This trend has notably occurred under the influence of some of the new foundations set up in the last ten years, foremost among them being the Bill and Melinda Gates Foundation. With an endowment of USD 24 billion, annual disbursements are above USD 1 billion annually,

93% of which benefit development directly or indirectly. More and more, foundations are emerging as essential partners of development alongside official institutions and the NGOs.

The need for instruments which are both more powerful and better adapted to financing human development

For human development, the quality of aid matters as much as its quantity. At present, official development assistance is mostly dependent on a yearly budgetary cycle[6]. Aid is usually conditional. It still comes frequently in the form of loans, even to the poorest countries.

To finance the MDGs, a significant change is needed. What is currently lacking is an instrument combining two characteristics: concessionality and predictability.

Concessionality: the need for grant money

Loans are appropriate when used to finance investments offering a high private return. But the logic of development in poor countries is different and requires heavy reliance on grants.

- First, there is a need to finance, over the long run, *recurring operating expenditures in basic social and public services*. Physical investments are necessary, but not sufficient. Efficiency depends on the ability to sustain expenditures over the long run. Equipments have to be maintained, doctors, nurses and teachers have to be trained and paid.

  These recurring expenditures frequently exceed the fiscal capabilities of the poorest countries, which are constrained by the narrowness of their tax bases (tax revenues frequently amount to less than 15% of GDP)[7]. While the social return on these expenditures is theoretically high, they do not yield external revenues within any foreseeable time frame that would permit repayment of any loan. This is why external aid—through budgetary and program support—is destined to play a growing role in covering these expenditures in the immediate future[8]. What is needed is a change in scale[9]. Africa would need to grow by 7% annually between now and 2015 to be able to finance- with no external transfers- the educational expenditures necessary to

achieve the MDGs. Burkina Faso, for example, has set a target of raising its primary school attendance rate from 40 to 70% by 2015. And yet, despite gradually raising the percentage of the national budget devoted to education from 12 to 20%, a further 20 million euros in aid will be required in order to close the funding gap.

- *Many poor countries are in no position to take on additional debt.* The poorest countries depend entirely on aid for their external financing. Therefore, any change in their debt is strictly dependent on the proportion of grants within that aid. The considerable efforts made within the framework of the "highly indebted poor countries" (HIPC) initiative have brought most of these countries to the limits of long-term viability and sustainability, based on standard projections of growth and of conditions in the international environment. This means that any unforeseen shock, and these countries are particularly exposed to them, would need to be absorbed entirely by fully concessional transfers. Otherwise, such shocks would trigger yet another downward spiral of debt and weak long-term growth. The international community currently lacks adequate instruments .

- It is also necessary to be able *tackle poverty in countries in situations of extreme distress or of armed conflict,* whose government and administrative structures have collapsed and whose borrowing capacity is nil. Nearly 60 countries experienced violent conflict in the 1990s. Fourteen million people are still suffering from famine as a result of these conflicts. There is clearly a risk that internal breakdown will be compounded by the collapse of local administration and basic social services— all this while rising military spending crowds out social spending. One can limit this risk by means of direct grant-financed assistance programs. Already humanitarian aid represents 6% of official development assistance and its share looks set to rise. These post-conflict situations thus call for totally concessional funds in order to restore government structures and resume public and social services[10].

- Finally, one needs to ensure financing for global public goods, especially those necessary to poor countries. Foremost among them is medical research into the pandemics affecting the developing countries. This typically can be defined as a "pure" public good, for which there is no alternative to public funding.

  Because medical research takes time and is risky, stable and guaranteed public funding is absolutely necessary. Otherwise the "public good" simply will not be

produced. That is the situation today for vaccines and for drugs to treat pandemics found exclusively in poor countries. At the dawn of the 21st Century, infectious diseases are still the number one cause of mortality in the world[11]. Of the 1,200 drugs authorized each year, a mere 13 are designed to treat tropical diseases[12]. The United States National Institutes of Health[13], the world's leading public medical research institution, spends USD 65 million annually on tuberculosis, which kills more than 3 million people per year in the third world, versus USD 2.7 billion annually in the fight against cancer[14] (see box 1).

The need for a predictable source of finance

ODA flows are highly volatile: four times more, on average, than recipient countries' GDP[15].

This volatility stems from several causes: the budgetary procedures in donor countries; changes in their priorities; administrative delays in making or implementing decisions; implementation of conditionality when the beneficiary's performance deteriorates. The poorer the country, the greater the volatility. Generally, it is impossible to ascribe this volatility to objective and identifiable causes. It is therefore impossible to anticipate. Aid is not only volatile; it is also, and above all, unpredictable.

The consequences are highly damaging[16].

Fluctuations in aid flows create additional macroeconomic shocks, whereas these countries need, on the contrary, resources, which would actually act as cushions against such shocks. Volatility also exacerbates internal and external financial imbalances if expenditures are carried out in advance, in the expectation of aid payments that then fail to materialize.

Unpredictability also considerably reduces aid effectiveness. It penalizes those investments[17] and programs most vital to development: investments may be cancelled because it becomes impossible to plan for them over several years in recipient country budgets; their effectiveness may be seriously impaired by lack of maintenance; frequent interruptions lead to an unsustainable increase in costs. These uncertainties especially affect programs most in need of long-term stability and continuity. Those are the programs that contribute most powerfully and directly to poverty reduction and the achievement of the millennium goals.

Many poor countries are caught in a spiral of diminishing aid where, for lack of stable and predictable resources, they cannot undertake the necessary physical and human investments in order to reduce poverty. As a result, the aid which does reach them is spent in a less favorable environment and is consequently less effective. Ultimately, this leads to further cuts in incoming aid flows.

These observations shed some light on the debate over absorptive capacity. There is a strong endogeneity here: if aid were more stable, it could be absorbed and administered more effectively, and in larger amounts. Increased predictability is thus *a sine qua non* of any global increase in aid volumes[18].

Private donations and attitudes to development

Private philanthropic transfers to developing countries – including donations and grants from private foundations- amount to several billion dollars a year[19]. In developed countries, however, much remains to be done to gather sufficient and strong support for the cause of development.

Uncertain motivations

Polls (both French and international) paint a mixed picture of peoples' feelings about development

Competing priorities[20]

- Private donations seem to be motivated first by a sense of urgency or proximity, followed by the occurrence of natural disasters and a sense of "being lucky." The Millennium Goals present a specific challenge, in this regard, because the objective (poverty reduction) may be perceived as both diffuse and distant (2015).

- Ranking third among motives for giving is a feeling of vulnerability: "it could happen to

me one day”. This is the reason behind the success of anti-cancer campaigns.

- It seems easier to mobilize against the perceived evils of globalization than around a positive objective: as a slogan, “reduce poverty” carries less weight than "fight injustice". Also, environmental degradation appears to be a bigger source of concern than the situation of poor people. Nevertheless, global hunger ranks first among concerns expressed (see box 2).

When asked, people do not give a high priority to solidarity with the poor countries. A mere 3% of the 220 billion dollars given privately by Americans goes to development. In-depth qualitative surveys carried out in France lead to a similar conclusion: if questions are open-ended (with no answer suggested), the fight against poverty is never mentioned. It only comes in response to specific questions. Development aid ranks 4th among motives for actual donations (17%), behind domestic healthcare, research, and education. When asked, in the abstract, about causes they think worthy of their financial support, French people rank development 6th (with 24%), far behind, for instance, medical research (70%) and children’s rights (46%).

Developing Countries: solidarity and concern

Public opinion in developed countries is increasingly sensitive to the pressures and risks of globalization. In this environment, developing countries may be perceived as competitors as well as partners. The resulting pressures can create a negative political dynamic if people become more reluctant to accept the consequences of economic openness and less inclined to make financial sacrifices for development. All the more so if, at the same time, they have to go through difficult adjustments in their own social benefits.

Mistrust of development institutions

Aid flows transit through national and international institutions, which do not always enjoy unequivocal support from the citizens. Underlying altruism may be inhibited by doubts about whether the resources will be efficiently managed. This institutional dimension is an important cause behind the lack of enthusiasm and support for development.

Citizens may doubt their government’s willingness to allocate their contributions to causes

they really care about. They may question recipient countries' aptitude for spending aid effectively. Indeed, 51% of French people say they would be prepared to increase development aid if it were better spent. People may also harbor a certain distrust or hostility toward international development institutions. It is known, for example, that part of the United States' opposition to any form of international taxation is historically linked to its view of the United Nations system. In France, on the contrary, the UN ranks first among trusted institutions (with 69% positive responses), followed by the European Union (61%), NGOs (57%) and the government (52%). Similarly, the image of the Bretton Woods institutions varies greatly from country to country and among opinion groups. In all, doubts about the effectiveness of ODA come second to personal financial constraints as a reason for not wanting to contribute. Significantly, hostility to taxation ("I pay enough tax already") only comes 8th.

How to make progress

Better information

Citizens know little about the costs and benefits of aid. Polls taken in the United States show that they tend to overestimate its level by a considerable margin. This may explain some of the resistance to an increase in ODA. Information may lead to a better assessment of the benefits of aid. It would show that, beyond worthy domestic causes, it is in peoples' rational interest to support an increase in ODA if that reduces the global risks to which they are exposed.

In recent years, and especially since September 11, 2001, these risks have become more apparent. But the public might not spontaneously see a linkage between these risks and the persistence of poverty in large regions of the world. Indeed, some experts would dispute that such a link exists at all, specifically with respect to terrorism. They would argue that the perpetrators of terrorist attacks usually come from countries that are already fairly developed, belong to the middle, or even privileged classes, and are relatively well educated. On the other hand, "failed states" clearly provide havens for terrorist organizations, and, by themselves, are a source of geopolitical destabilization[21]. Finally, some risks associated with globalization—health risks notably—are clearly linked to poverty and under-development. More intensive information about those risks would make it easier to grasp the importance

and urgency of increasing aid, not only for the benefit of recipient countries but also for the sake of developed countries and their national interests. [22].

Transparency of aid

Transparency is essential to create trust and support for an increase in aid. It may necessitate important changes in the way resources are managed and allocated. This issue is discussed in depth below, when "innovative financing mechanisms" are examined.

The current official development assistance system

To many observers, an increase in ODA is the best response to the challenges presented by poverty and human development. All it takes, for developed countries, is to honor their commitments through additional budget expenditures. Some would consider plans to create innovative mechanisms as an escape route or a diversion from the real issue : the need to transfer more resources to poor countries (see box 3).

This is a powerful argument, but one which misses an essential point about the inner workings of the international aid system.

This system is currently organized through network of bilateral and multilateral relations between recipient and donor countries. This complex architecture rests upon informal coordinating mechanisms between countries whose objectives may converge or (more frequently) diverge. There is no shortage of structures and procedures for agreeing on joint programs and actions. But donors still keep discretionary power over their contributions, sometimes informally binding themselves into jointly agreed programs or frameworks.
The impact and efficiency of such a system, is dependant on how the actors interact with each other.

Voluntary equilibriums

Informal and flexible coordination works best when countries wish to pursue their own specific goals. This is often the case for development aid[23], which is also an instrument of

foreign policy. Beyond pure geopolitical motives, donors may want to promote their own view of the world, their own approach to development, and define their conditionality accordingly. (Three quarters of development grants are made bilaterally and two thirds of the poorest countries receive only one third of ODA).

For recipient countries, the resulting competition between donors can be judged either beneficial or harmful. Developing countries certainly pay a price in terms of increased inefficiency, and they are faced with numerous constraints and inconsistencies. But the system also gives them an element of freedom and choice. They can avoid subordinating their development policy and strategy to a single and monolithic vision. Current practices also allow for some degree of innovation and experimentation, as well as for comparison between competing visions and doctrines.

MDGs and the need for a cooperative equilibrium

With the MDGs, donors and recipient countries have jointly and explicitly agreed on specific objectives. Here, purely voluntary cooperation does not produce optimal results (see box 4).

- First, it does not deliver adequate resources[24]. Each country naturally seeks to free ride on others' contributions[25]. There are numerous strategies for achieving this. Donors generally direct most of their bilateral aid toward their own priority programs or countries. At the same time, they try to delegate the implementation of joint programs to those institutions to which they contribute least. The outcome is distinctly sub-optimal.

- Second, it imposes high transaction and negotiation costs. Donors spend a great deal of time and resources seeking compromises. Recipients find it increasingly difficult to cope with the system's complexity and uncertainties. Reconciling the various and not entirely consistent demands of donor countries greatly complicates the task of administration and planning.

- Finally, the volatility of aid flows may be seen as unavoidable when aid is conditional and largely left to the donors' discretion. Currently only debt reduction mechanisms contain an element of automaticity. Other forms of aid, even when framed within annual or multi-year programs, remain subject to the uncertainties of coordination among donors and their dialogue with recipients. We know from experience that those processes

produce unstable equilibriums. Agreements have to be reached for each program or type of expenditure and there is no mechanism that would provide a guarantee against the risk of free riding.

In sum, aid flows are determined by: the behavior of donors whose goals and priorities may be frequently shifting; recipient countries' performances, which is uneven over time; and finally, external shocks, which may themselves have an impact on recipients' economies and performance. The interaction of these three forces is a major source of uncertainty and instability (see box 5).

Admittedly, significant improvements are being brought to the system. The declining trend in aid has been stopped and reversed in the last few years. Untied aid is increasingly predominant. Program (or budgetary) support is now supplementing or replacing project aid. Aid is also becoming more concessional. Conditionality is changing, with greater emphasis being put on institutional quality and good governance .

Finally, the effectiveness of aid has been subject to a number of reviews in recent years, and considerable efforts have been made since 2002 to harmonize aid procedures in order to reduce the constraints and the efforts they impose on recipient countries.

But these reforms have not fundamentally altered the system's architecture and its instruments. One essential element is still lacking, namely a resource that is both concessional and predictable. Such a resource can only be produced by a strong and permanent coordinating mechanism.

Innovative financing mechanisms

Most national budgets are decided and voted annually, which makes it difficult for developed countries to provide stable and predictable aid flows. Innovative financing mechanisms seek to relax and ultimately lift this constraint while at the same time mobilizing additional resources.

The International Finance Facility

The International Finance Facility (IFF) is a development financing mechanism proposed by the UK Government and supported by France.

The rationale behind the IFF is the urgent need to mobilize resources in order to meet the Millennium Development Goals. While many governments have committed to increasing their ODA, this increase is bound to be progressive.

The IFF is designed to use capital markets to frontload future increases in development aid. The IFF is a funding platform and performs a treasury function. It would periodically collect formal and irrevocable multi-year pledges by member countries to make future contributions. It then issues bonds whose repayment is guaranteed by those pledges (allowing funds to be raised on the best possible terms). The proceeds are then used to finance development, mainly in the form of grants. If the mechanism works, it will generate stable resources, the rate of disbursements being disconnected from that of contributions.

The IFF presents many attractive features, and also raises a number of questions.

It can be implemented on a regional basis or by a limited number of countries, since it does not immediately weigh on the economy and hence does not create problems of competitiveness[26]. Faster disbursement of aid is justified for some human development actions. Finally, it makes perfect sense to use capital markets to manage the disconnection between flows of revenues and expenditures with different schedules over time, provided their values are equivalent.

Several important issues need to be addressed, however. The IFF governance structure and allocation mechanisms have yet to be defined. In many countries, budgetary rules would impose accounting for future pledges as immediate expenditure commitments. As with all borrowing, the IFF transfers the burden of repayment onto future generations, with no guarantee as to the return on the investment concerned. A major question mark thus hangs over the long-term future. After 2015, a proportion of developed countries' ODA budgets will be absorbed by IFF repayments. At that point, this could lead to a sharp reduction in net flows toward poor countries. The risk is limited but nonetheless very real, should future budgetary pressures in countries, particularly those with aging populations, prevail over the desire to reduce poverty.

Hopefully by then, several countries that currently receive aid will no longer need it, having reached a sufficient level of development. Others however, will still be in need of help. This is certainly the case for many countries in sub-Saharan Africa. Even with optimistic

assumptions for growth and national tax rates, these countries will still be unable to shoulder the burden of public spending essential to human development. The poorest countries will still need help after 2015[27]; and it is precisely those countries that would ultimately bear the risk attached to frontloading, unless other stable sources of funding have been put in place by then (see box 6).

International taxation

It is important to define and clarify, from the outset, the concept of international taxation.

There is no such thing as an international authority with the power to tax. In today's world, only sovereign states have the legitimacy and capacity to enact and enforce compulsory taxation.

Similarly, there is no such thing as an "international" tax base, i.e. one that could be mobilized outside the authority of national governments. Economists and political scientists have identified planetary "common goods," which are the common heritage of the world's inhabitants. They include the oceans, space, and the atmosphere. But only national governments can capture these goods for the purposes of pricing or taxing their use. One feature of globalization is that some economic factors have become increasingly mobile, to the point where they seem to have vanished into some other, more international space. But this impression is deceptive. This mobility occurs between the fiscal jurisdictions of different countries, between which there is no such thing as a legal international space.

Consequently, an international tax would necessarily be the outcome of an act of cooperation between sovereign countries. It can be defined as a set of identical or convergent national tax mechanisms, implemented jointly by these countries within a common, agreed framework, encompassing the utilization of the funds levied by each of these states.

This cooperation would need to be negotiated and legally formalized. It means that an instrument of sovereignty, the power of taxation, would be subordinated to an international common objective.

Creating an international tax would imply international agreement on a basis and rate of taxation, together with institutional arrangements for collecting it.

International taxation therefore, calls for a high degree of international and institutional cooperation, and it may entail some pooling of sovereignty. In that sense, it is only applicable if and when countries' preferences are fully convergent.

Once these conditions are met, however, an international tax would bring huge benefits:

- It would solve once and for all the coordination and burden sharing problems;
- It would ensure the continuity and predictability of aid flows, including over the very long term;
- It would eliminate transaction costs and dispense with cumbersome negotiating procedures;
- It would establish a system for fighting poverty on solid foundations, and protect it from the vagaries of politics and international cooperation;
- Finally, it would not put any additional burden on future generations. In that sense it would appear particularly suited to three categories of spending, namely:
    - Solidarity among existing generations (e.g. immediate healthcare expenditures, and countries in emergency situations);
    - Expenditures with risky, uncertain social returns (e.g. medical research);
    - Expenditures needing to be carried out over the very long term.

The IFF and international taxation are complementary

There are powerful complementary features between the IFF and international taxation:

- First, economic: The two instruments can be used jointly when expenditures designed to benefit present and future generations are closely combined within a single program or action. In healthcare, for example, some expenditures, such as vaccination, prevention or education, are in fact an investment in the future, whereas others are more a question of immediate solidarity. It must be possible to find suitable funding for both;

- Second, financial: a tax resource may serve to secure or consolidate a more sophisticated package based on loans and guarantees;

- Finally, they are complementary over time: the tax resources will still be available in the long run, when the IFF's disbursement period is over.

How much is needed?

Numbers usually associated with the millennium goals reflect total financing needs whether they take the form of loans, official grants, or private flows. They cannot automatically be translated into a revenue target for international taxation.

Two approaches can be considered. One could seek to cover the majority, or even the near-totality, of the financing gap by means of a tax resource; if successful, this would provide maximum security for funding the MDGs. However, such a high level of new taxation would most certainly strengthen the opposition.

Alternatively, one could concentrate, at least initially, on a "core" of fundamental needs that absolutely require stable and concessionnal funding. This approach may seem insufficiently ambitious. Yet, irrespective of the amount, the mere fact that such a resource exists would transform the landscape and the nature of development aid. Initially, even a limited contribution would raise the return on other forms of funding by creating an environment in which they can be effective.

It is hard to estimate precisely and comprehensively the needs for this type of resource. It is worth noting, however, that[28] :

- With less than USD 1 billion a year, all of the world's poor could have access to

approximately thirty basic surgical procedures;

- USD 2 billion a year would finance research into a vaccine against malaria;

- USD 2 billion annually could cover the cost of emergency humanitarian aid and provide assistance to failed or distressed states.

- USD 2 billion a year would guarantee primary education for all children in the poor countries of sub-Saharan Africa;

Managing the resources

How can stable and predictable resources be administered effectively? Relations between donor and beneficiary countries rest on a delicate and unstable balance between altruism and conditionality. Greater stability in transfers to poor countries could modify this equilibrium; however this raises some questions and doubts.

A first set of issues relates to the management of funds if the proceeds of an international tax were to be specifically allocated to one or several MDGs. One would have to insure the coherence between actions carried out in those specific sectors with actions carried out in other sectors (as is currently being done in donors' country programs). Also, earmarking revenues may run contrary to traditional principles of fiscal management (more on this later in the report).

The central, and most difficult, question, however, is about conditionality. In principle, conditionality is intended to ensure that the resources transferred are used efficiently. Stable resources create a moral hazard problem, whereby recipient countries may lack sufficient incentives to pursue "sound" policies. This question is a complex one, however, since a variety of causes can be responsible for the disappointing performances recorded in many countries: quite apart from poor administration, other factors involved may include unexpected shocks, including those brought about by the volatility of aid itself, as pointed out earlier. One may also ask whether populations, especially in countries in a state of extreme distress, should have to suffer the adverse consequences of government failures; or whether, on the contrary, aid should be used to protect them from the consequences of those failures (see box 7).

Additionality

A new tax or levy does not necessarily bring additional resources. Evasion may erode the tax base. The resulting revenues may, for a variety of reasons, be diminished by a reduction in the proceeds of other taxes.

This question is especially acute in the case of an international tax. By definition, this tax would coexist with existing official development assistance flows. However, there is a risk that, instead of increasing aid flows, the proceeds from an international tax would actually crowd them out. Each government may chose to scale back its ODA budget in response to the emergence of a new source of funding, e.g. in the form of a tax. In extreme cases, the substitution might be total. Thus, the introduction of a tax into a primarily voluntary system might not necessarily increase the overall amount of aid.
Most developed countries today are subject to stringent budgetary constraints, which may lead to a reduction in ODA, should new revenues be created from an international tax. In the past, that debt reduction has sometimes replaced, not added to, other existing forms of aid.

There is no perfect solution to this problem, which the IFF also has to face to the same extent. In the short run, there would certainly be a need for greater multilateral surveillance of aid policies and commitments.

Beyond that, additionality of an international tax is linked to its acceptability, which in turn, strongly depends on its allocation mechanisms and conditions of governance.

Earmarking

In pure public finance, it is generally considered inadvisable to earmark a given revenue for a specific expenditure, since this introduces an element of rigidity to the allocation of resources[29]. The dynamics of revenue and spending rarely coincide over time, leading either to waste or to inadequate funding. Earmarking also makes democratic control and governance more complicated, and tends to perpetuate programs and structures which have outlived their purpose.

In the case of an international tax however, at least partial earmarking may prove necessary

and useful.

First, it introduces a direct link between donors and beneficiaries. This link would lend greater legitimacy to an international tax, therefore making it more acceptable and consequently, more additional.

Earmarking can also serve to experiment with new approaches for distributing aid and make it easier to reach poor people, who frequently find themselves with no access to normal channels of public and private finance.

Earmarking can take different forms. Responsibility for administering part of the tax revenues could be delegated to non-governmental partners. New or existing trust funds could also serve as a natural receptacle for international tax revenues (creating for non participating countries an incentive to join). Finally, where funded actions closely complement those undertaken by the international institutions, the taxes could be paid into trust funds lodged within these institutions, being administered according to the priorities and rules laid down by the donor countries while benefiting from the leverage provided by multilateral funding.

Governance

As pointed out earlier, the public image of some institutions does not fully reflect their level of competence and expertise. This contradiction needs to be managed with pragmatism and imagination. It may not be realistic to solicit taxpayers to provide unspecified funding for existing organizations. But it would be equally detrimental to systematically exclude those organizations from the allocation and management of tax revenues. Innovation in governance should, therefore, develop in parallel to innovation in financing.

New forms of governance could help and promote new practices of public-private partnerships in development aid. As evidenced by philanthropic foundations, such partnerships can be highly productive, and could no doubt provide a worthwhile channel for the proceeds of any international tax. Bringing in non-governmental partners could offer a guarantee of sound administration as well as generating catalytic effects. Some public development actors may view the emergence of these partnerships with misgivings or even reluctance, and may legitimately fear a dilution of their power and priorities. Here again, institutional innovation will be essential. If properly organized, the involvement of these private partners in actions financed through an international tax would unquestionably

enhance its legitimacy.

All in all, an international tax can be truly additional if and when:

- Burden sharing is explicit and transparent;
- It comes with guarantees (political, institutional, and legal) regarding the volume of existing flows;
- It can be linked to specific and unanswered needs, thereby revealing hitherto unexpressed preferences
- It is allocated and administered in a climate of transparency and integrity beyond suspicion and criticism.

PART TWO: OPTIONS FOR AN INTERNATIONAL TAX SYSTEM

Here, we describe and analyze the possible characteristics of an international tax mechanism for development[30].

Three issues are addressed: first, how an international tax would fit in the global tax environment; second, the policy choices regarding the efficiency and equity of such a tax; and, finally, the legal architecture and possible design of international taxes.

International taxation in the global environment

Globalization has created a new environment for tax policy. Existing tax systems have been mainly designed for closed economies, where all factors of production could be considered as immobile. As economies have opened up, factors such as capital or skilled labor have become mobile, and hence more responsive to levels of taxation. This new environment creates both the conditions for increased competition between national tax systems and better opportunities for tax evasion.

These are two different issues:

- Tax competition, as opposed to harmonization, is a matter of policy choice . There are considerable divergences among countries (and throughout public opinion), including within the European Union, on the costs and benefits of tax competition, and on the necessity of greater harmonization. This debate falls outside the scope of this report.

- Tax evasion is a form of behavior by private agents, either within the limits of the law (through tax optimization), or on the borderline of legality.

> Tax evasion is closely related to the topic of this report. It may compromise the morality of international financial activities. It may be based on the same techniques and methods as those employed in criminal activities. It may also illegally reduce governments' tax revenues and hence resources available to finance public goods.
>
> Above all, tax evasion deprives poor countries of the resources necessary to their growth and development. The loss in tax revenues generated by evasion in developing countries may be equivalent to the sums needed to achieve the Millennium Goals. So it would be pointless to think about international taxation or, more generally, about innovative financing mechanisms, if at the same time little is being done to help rebuild these countries' taxation capabilities, which is an essential condition for their development. Contrary to tax competition, governments agree, in principle at least, on the need to fight tax evasion. Considerable efforts are being made through tax cooperation within the OECD, especially on the issue of tax havens.

Finally, international taxation is a new, and still undeveloped, method of cooperation between governments for the funding of common priorities. It could prove to be a suitable instrument for accommodating competition between tax systems, by partially attenuating its impact on governments' funding capacities. Unlike harmonization, it leaves governments free to determine their own tax policies. It also creates a limited space for coordination for the purpose of joint actions.

Efficiency, justice, and equity

All tax systems are based on a trade-off between efficiency and equity. This trade-off is defined by the ultimate objectives assigned to the system. In a global setting, there are four such possible objectives: correcting externalities; moralizing the international economy; redistributing income; and financing development.

Correcting externalities

Externalities arise whenever actions from economic agents have consequences, which are not fully captured into prices and costs, and therefore not taken into account by themselves or other agents when making their decisions. Externalities can be positive or negative. Atmospheric pollution, when created by human activity, is a standard example of a negative externality. Because externalities are not naturally reflected into prices and costs, they create a market failure and generate economic inefficiency (i.e. for instance, too much pollution as compared to what people would naturally be prepared to accept). A good way to correct or eliminate negative externalities is to levy a so-called "Pigovian" tax, whose effect is to bring private costs in line with the social cost, thus "internalizing" the externality. The tax leads agents to take account of the whole social cost when making their decisions. Unlike all other taxes, such taxes do not create any new distortion. On the contrary, they restore the efficiency of the market mechanism (see box 8).

The case for Pigovian taxes can also be made on a global scale.

Many externalities, especially environmental externalities, transcend national borders. They naturally call for an international response. No country could or should act alone to correct such externalities. Individual action is pointless if the externality lies beyond the reach of any individual country. It is also dangerous, since corrective taxes inevitably have an impact on the relative competitiveness of activities, economies, and regions. Taxes designed to combat greenhouse gases are a case in point. Unilateral implementation by one country would have no significant effect on overall emissions and could seriously affect its competitiveness, especially if rates were set so as to fully compensate for their environmental damage. As a consequence, such taxes can only be envisaged where there is strong international cooperation.

Of course, taxes are only one among many available tools to deal with environmental externalities. Other possible instruments include emissions standards and quotas, as well as marketable permits.

In a global setting, the choice between these instruments depends on judgment about their effectiveness, their distributional impact between countries as well as, more generally, the intensity and modalities of international cooperation.

Moralizing the international economy

A tax could contribute, in some cases, to discouraging specific activities. To the extent that some activities are deemed immoral or dangerous, such a tax could be welfare-enhancing from the point of view of the international community.

The proposal to tax arms sales partly falls within this definition. To many observers, military expenditures have detrimental effects on political stability and economic growth. They absorb an excessive share of developing country budgets, especially in countries with undemocratic regimes. Arms sales are also considered insufficiently transparent and act as a conduit for corruption.

A "moralization" tax seems very natural and, by itself, legitimate, whatever use is made of its proceeds. Its rate can be set as high as deemed necessary, without any consideration of the demand elasticity and any concern for the negative impact on the tax base. Such a tax could have a signaling effect and help to mobilize public opinion against immoral activities.

There is also, however, an element of paradox to such a tax. Raising public revenues from an "immoral" activity may be awkward, especially if it helps to give additional legitimacy to that very activity. A purely moral approach would prevent or forbid immoral activities, not tax them.

Income redistribution

In most countries, taxes are used, to some extent, to modify income distribution and correct inequalities. Could and should global taxes be designed with such a purpose? This is a valid question, which needs to be addressed: rightly or wrongly, global inequalities are often perceived to be on an increasing trend. But it is doubtful that international cooperation will produce a concrete response to that perception either now or in the foreseeable future.

First, there is no consensus on the diagnosis. Judgments differ widely as to whether global inequalities have increased or decreased over the last decades, together with the most recent phase of globalization. As measured by synthetic indicators of worldwide income distribution (gini coefficient), global inequality has been stable over the last three decades- or even decreased slightly - after a sharp increase in the first sixty years of the 20th century. A different measure, such as the gap between the highest and lowest levels of income, would on the contrary, show a significant increase.

Second, there is no consensus as to the best approach to deal with global inequality. Inequalities between countries are far greater than those within each country. But one can draw opposing conclusions from this. Some take the view that financial transfers between developed and developing countries are a crucial instrument for reducing global inequalities. For others, economic growth is the main driving force behind the reduction of global inequalities, by allowing emerging and developing countries to catch up with developed countries and promoting convergence in worldwide living standards.

Financing development

Finally, international taxes may be created for the sole purpose of raising revenues. The choice would then be determined by two simple characteristics. First, the revenue potential: ideally the tax base should grow fast enough to meet the need for increased resources over time. Second, collection costs should be as low as possible.

Priorities

No tax however, serves a single purpose, and many actually seek to achieve several goals

at once. A tax on arms, for instance, would both raise revenues and aim to discourage sales. Environmental taxes seek to correct environmental degradation while, at the same time, bringing additional resources.

Here, the report makes choices and defines priorities. At this stage, the aim of international taxation should be to raise the resources necessary to achieve the Millennium Development Goals. Any international tax should be designed first and foremost as a financing tax. Revenue potential is the main criteria through which all available options should be assessed.

There are two fundamental motivations behind this choice:

- Income redistribution is the outcome of a political process which, in most countries, is based on democratic decision making mechanisms. We know from observation that countries differ widely as to the desirable or acceptable level of income inequality. There is no worldwide democratic process to reconcile these differences and decide on the appropriate level of income distribution and modalities for reducing inequalities.

  What does exist, however, is a universally accepted goal of global poverty reduction. The approach here is different. The international community has decided to focus on the situation of the poorest people, not on the gap between different levels of income around the world. This approach is based on well-established philosophical and ethical premises[31]. It can therefore serve as a reference point for defining and implementing mechanisms for transferring resources to the poor countries. This is the approach which best legitimizes international taxation today[32].

- International taxes can improve the overall economic efficiency of development financing.
  First, corrective taxes, such as environmental taxes, would raise revenues without creating any new economic distortions, and actually eliminating some. This is the so-called "double dividend" whose existence and reality, however, is debated (see box 8).
  Second, taxes levied, at a very low rate, on internationally mobile tax bases would be less distortionary than additions to existing national taxes, whose rates are already much higher. Thus, financing supplementary development needs through such

international taxes would bring net benefits in terms of economic efficiency. This would, all things being equal, allow for a greater level of aid: it is a standard result of economic theory that one can finance a greater volume of public goods by reducing the distortions created by taxation.

It is impossible, however, to create such international taxes without strong international cooperation.

One possible answer to this problem is tax harmonization. As already mentioned, there is no consensus on this issue. Many countries view tax competition as a normal, even desirable, practice. They don't want the freedom to determine their own tax, fiscal and social policies to be impeded by tax harmonization. In addition, tax competition is seen as a good way to limit to the growth in public spending and government interventions.

But, if and when countries agree to jointly finance additional development spending, then it would be more efficient to do so through international taxes rather than by increasing national taxes. An international tax system would, therefore, preserve tax competition between countries, if they so wish, while at the same time provide an economically efficient base for funding an increase in development aid.

Once this financing priority is met, however, other objectives can and should also be pursued (and serve as secondary criteria for decision).

Creating an international tax would represent a major political decision and would be inseparable from a much broader vision. It would encompass an aspiration to greater global stability, more security and more justice in global development. It would give practical expression to the sense of a common bond between all of the planet's inhabitants: between those -the vast majority- for whom globalization is a source of progress and greater prosperity, and those -still too numerous- whom globalization has left behind, and who are penalized by an accumulation of historical, natural or geographic handicaps.

This vision is embodied in the Millennium Development Goals. A global tax should contribute to this vision and, as such, should not result in new burdens or handicaps for poor countries. New contributions should never be regressive but rather neutral or progressive

(with the level of income). They could also, when appropriate, help moralize economic and financial activities.

Architecture

The power to tax is an essential attribute of sovereignty and, in democratic countries, has always been closely associated with direct political representation. Such representation does not exist at the world level. This could call into question the legitimacy of any international tax.

Some proponents of international taxes would see their creation as part of a bigger project : the creation of new forms of global governance, that international taxation would help to promote and consolidate [33].

This is the perspective adopted by the Zedillo Commission on development finance, which calls for a world council of Heads of State and Government to promote better global governance. The Commission also recommends the creation of a world tax organization to study, among other things, the technical feasibility of an international tax. This is a very ambitious approach, but one that would ultimately create the most robust structure for international taxation.

However, institutional progress takes time. And it is not clear that institutional changes would, by themselves, bring an evolution in international funding mechanisms. The European Union is a case in point. Although they have achieved unprecedented economic and political integration, backed by strong institutional arrangements, member countries have yet to agree on the principle of a European tax.

A more realistic approach, and one best suited to the urgent need for resources, is to work within the existing international system, where only sovereign states have the power to tax. Any new -and more automatic- development funding mechanism would have to be built on their explicit consent.

Legal framework

An international tax would be based on a two-tier legal architecture:

- First, national legislations would enact the tax within each country's jurisdiction;
- Second, countries would agree on a coordinating mechanism whereby they would jointly implement their national decisions.

How those two tiers would relate to each other [34] would determine whether the tax is more or less "international" and would give the legal architecture its defining characteristics (see box 9).

Several options would be available to participating countries as regards the coordinating mechanism:

- it could be more or less detailed and prescriptive. At one end of the spectrum, countries would only agree on a specific formula to set their contributions, while retaining their autonomy as to how those would be funded. This is a case of countries "taxing themselves"[35]. At the other end, they would implement the same tax, with identical tax rates and tax bases in all countries.

- It could be more or less binding. In a flexible, non-binding framework, cooperation on taxation would be strictly voluntary and revocable, and could be based for instance on a joint declaration. As regards the MDGs, the declaration could specify, for instance, those taxes whose proceeds would be allocated to specific development purposes, together with some monitoring mechanisms.

  Another approach would be, for participating countries, to sign an international treaty that would bind them for as long as they do not denounce it. The treaty would prescribe the rules governing national contributions, and, if so decided, the tax base, and rate as well as the mechanisms for collection and allocation of revenues. There are no such treaties at present. This approach would mark a major qualitative change in the field of international tax cooperation: governments have never yet agreed to such strict limitations on their sovereignty. But they have consented to other, fairly similar limitations. Trade treaties in particular, bind tariffs duties and narrowly circumscribe signatories' freedom to subsidize productive activities or even to use internal taxation power (to the extent that it would discriminate between residents from different nationalities).

Approaches to taxation

A great number of options are available for the design of an international tax system. Here, we identify three broad possible approaches.

Coordinated tax incentives to international private philanthropy

Most developed countries encourage private philanthropy through tax incentives. But those mechanisms do not specifically discriminate between domestic and international donations (for development). And they might differ widely from one country to the other. Up to now, domestic tax systems do not give any priority to development aid, nor do they signal any such priority, which could shape the perceptions of private individuals and influence their behaviour.

Great progress would be achieved if developed countries were to establish a coordinated, uniform system of tax incentives for private donations to development[36].

If this were additional to existing mechanisms, such a system would undoubtedly be costly. But it would also bring important benefits:

- Implementation would be easy. No new institutional or legal arrangement would be necessary. A joint declaration by participants would suffice, together with implementing legislation in each country.

- Public funds would be leveraged by private contributions.

- It would thus help mobilize public opinion for the cause of development.

- It would be especially suited to countries where public opinion is most reluctant towards all forms of compulsory taxation and government intervention.

- It would introduce a more direct, and hence powerfully educational, bond between individual donors, contributors and the ultimate recipients of aid.

Such a system would not necessarily deliver stable resources nor would it establish a predictable burden sharing mechanism between countries. But it would give governments greater insight into public opinion by acting as a "preference- revealing" mechanism and, as such, would help in efforts for development resource mobilisation.

These "new" donations could conceivably crowd out other forms of philanthropy. The risk however is limited. Observations show that total private donations are higher in those countries with high levels of ODA. This suggests that substitution effects between different forms of contribution might be weak. The risk is worth taking, furthermore, if the priority for development is to be taken seriously. Finally, it should be noted that appropriately targeted tax incentives could strongly help NGOs in their fund raising, thus increasing the leverage effect of public spending.

Additions to existing taxes

Contributions to development aid could be made through additions to existing taxes. Such contributions would be easy to implement, with very low additional collection costs, and would yield automatic and fairly predictable revenues. If they come in addition to taxes based on broad economic aggregates, significant resources could be obtained with a limited increase in the tax rate, thus minimizing the economic cost.

To the extent that the tax bases would mirror national wealth and prosperity, those additions could be seen as a form of international solidarity contribution.

As an instrument of solidarity, however, an addition to existing taxes is less than perfect: the burden sharing would also reflect existing differences and distortions between tax bases of a similar nature between participants . However, this drawback needs to be weighed against the key benefit of using existing tax bases and methods.

New global taxes

There are three possible categories of such taxes:

- Those levied on infinitely mobile tax bases at the national level (e.g. financial assets), which, therefore, can only be taxed through international cooperation. In addition to being dynamic, thereby ensuring strong revenue growth, these bases are sufficiently broad as to allow for very low, i.e. non-distorting tax rates.

- Those, which, if implemented nationally, would lead to a substantial loss of competitiveness (environmental taxes are a case in point). Despite their corrective function, the rate for those taxes could be determined primarily with a revenue-raising objective, at least initially.

- Taxes levied on planetary common goods belonging to humanity as a whole and which, under the existing system of tax jurisdictions, are captured by no one (such as space and ocean resources with the notable exception of polymetallic nodules). These are scarce and non-renewable resources. Nevertheless, the existing international legal framework paradoxically provides unlimited and free access. In the long run, when over-consumption will become more apparent, this will become a major challenge for cooperation among countries. In the immediate future, taxation may be useful to help move closer to optimal pricing of these resources.

Financing channels[37]

A first option would be for the tax revenues to be collected directly by an international organization. This could only be possible if the tax base is clearly identified and subject to immediate verification. In this case, direct collection may lower collection costs and makes the final allocation of the proceeds perfectly clear . Such architecture already exists in some international treaties. One example is the Universal Postal Union, whose development assistance instrument, Quality of Service Fund (QSF), is financed by a contribution from each of the industrialized countries equal to a small fraction of terminal dues paid between postal administrations. Similarly, until its demise on January 1, 2002, the European Coal and Steel Community (ECSC) was partly funded out of direct levies on steel firms.

Under a second option, the tax would be collected as a national tax, recorded as a non-earmarked revenue item in the budget, like any other tax revenue, and then paid out to the international organization as an item of expenditure. This is the mechanism used for the "VAT resource" in the European Union; it preserves parliamentary control and opens up the possibility of revenue sharing. Its allocation is less guaranteed and less transparent, however, which may make it harder to defend before public opinion.

A last option, a variant of the previous one, is the earmarked tax. It is identical to the previous one with one major exception, namely that there is an unbreakable legal link between the revenue and the expenditure. This mechanism is used for European Union agricultural levies and customs duties.

Global or regional taxes ?

Universal consensus on international taxation is certainly an objective, but one which might prove difficult to achieve in the immediate future. Is there then, a possibility to create regional taxes?

This question is especially important for those who would like to see the European Union expanding its role in development assistance. With such a tax resource, Europe would be able to play this role to its fullest - a role that could well be seen as both justified and necessary given the strong sensitivity to development issues on the European continent.

There would be obvious adverse consequences for the competitiveness of participating countries and important risks of evasion. Any new tax also has a signalling effect to the extent that it may fuel expectations of future rate increases. This may be especially detrimental if the initiative is confined to Europe, given our continent's already high level of taxation. Finally, those countries that do apply a regional tax may find themselves funding a public good that benefits the "exempted" countries, thereby making a significant transfer to the latter.

On the other hand, it might be useful to start a process, which could later lead to broader acceptance and participation. Most of the major advances in international cooperation in

recent decades have been made by a pioneer group of countries.

Both sides of the argument can be made with equal force. Clearly, some taxes would more easily applicable in a regional framework than others in terms of both the risk of evasion and the impact on competitiveness. This de facto limits the range of available instruments[38]. Countries that would decide to implement such regional taxes should also ensure (in the allocation and management of the resources) that sufficient incentives exist for others to join in (or be penalized for abstaining).

PART THREE: ORIENTATIONS

This section reviews specific measures discussed and studied by the group. Some were scrutinized in great detail, while others have been discussed in more general terms at this stage.

These measures can be grouped together in a number of ways[39].

Voluntary or compulsory contributions

Some are genuine taxes. Others are purely voluntary, as in the case of an additional charge on credit card payments or on water, electricity and telephone bills. While individuals remain free to contribute, these mechanisms may be enhanced through various incentives. Voluntary contributions do not provide totally stable resources nor is their allocation to development actions guaranteed. A possible way forward for the major developed countries might be to encourage private generosity and philanthropy toward international development and poverty reduction, using similar incentive mechanisms.

Proposals for a global lottery also fall into this category, with the additional advantage that the proceeds can be allocated to causes clearly identified by governments.

Fiscal, quasi-fiscal or monetary

An additional allocation of special drawing rights (SDRs), has been frequently suggested and would be highly beneficial to the poor countries. However, SDR is a monetary instrument, and, as such, cannot be used directly to finance budgetary expenditures for human development. It could, however, substantially alleviate poor countries' constraints in external financing, notably in the event of sudden, unforeseen shocks.

Similarly, fighting international tax evasion would not immediately yield any new and guaranteed revenues. However, it would help consolidate developing countries' tax bases

and increase their budgetary receipts in the long run.

Universality

Some taxes lend themselves more easily to an application limited to a few countries. Others do not. A corporate income tax surcharge, for example, would necessarily have to be implemented globally since partial implementation would impair the ability of participating countries to attract foreign direct investment. Some taxes on aviation or shipping, on the other hand, could technically be imposed on a limited scale with little serious risk of delocalisation.

Taxes on financial transactions are more complex to judge, from this point of view. Partial implementation would only be possible if markets were segmented. It would be impossible for large-scale transactions in fungible and homogenous assets. In general, high capital mobility and globalized financial markets make it difficult, if not impossible to create a tax which would not be applied in all major developed countries.

Criteria for choice

All contributions discussed in this section share common characteristics:

- They are technically feasible;
- They would raise significant revenues and contribute to the financing of the Millennium Development Goals;
- They are economically rational, designed to minimize new economic distortions, or eliminate existing ones
- Finally, it would be impossible to collect any of them without extensive international cooperation.

This last point is crucial, since it provides the justification for using the proceeds to finance development. One could argue that there is no logical reason why a tax on financial

transactions, for instance, should be used to finance poverty reduction. But such a tax could not be implemented by any single country acting alone. It can be considered a “product” of international cooperation, therefore legitimizing the use of its revenues to finance the pursuit of common goals.

Enhancing voluntary contributions

Voluntary contributions in addition to tax payments

The standard tax return can be used as a medium for encouraging people to make voluntary contributions, especially if backed up by specific tax incentives.

Such mechanisms exist in many countries :

- Some countries allow taxpayers to make an optional additional payment when determining their income tax, which may then be totally or partially deductible. The decision is made when filing one’s tax return. Switzerland, Denmark and Germany, for example, apply a “church tax,” which can generate considerable revenues (9 billion euros in Germany, in 2002,). Depending on the country, taxpayers can either opt in or out of the system. Opting in is less binding, but it has been shown that opting out generates higher revenues.

- Voluntary contributions to development may be matched by public funds. This formula works best, however, when people are asked to display generosity in everyday acts such as making purchases or paying their utility bills.

Contributions when engaging in routine acts of consumption

Credit card payments

Bank card debits in Europe totaled USD 824 billion in 2003 (for Visa cards alone), with

payments accounting for 70% of that figure and cash withdrawals for 30%. A 1% contribution could potentially raise USD 8 billion .

Cardholders could make a voluntary contribution in two ways:

- At each payment or cash withdrawal. This formula preserves maximum freedom on whether or not to give, but it is technologically very complex and its cost would probably be prohibitive. Legally, it is essential that the amount shown on the paper receipt precisely match the amount debited from the holder's account. If holders were given the option of making a contribution at the payment of each transaction, it would be necessary to adapt all existing payment terminals (there are 1 million in France).

- On all payments made with a specific card. In this case, the amount is debited periodically and appears on the holder's card statement. The payment circuit is unchanged and the card-issuing bank debits a lump sum from the donor's account. This option thus takes the form of an automatic debit contract between the card user and his bank (or financial service provider that issued the card). In France, Crédit Coopératif's "Agir" card utilizes a specific contract whereby customers agree to a debit of 0.06 euro for each cash withdrawal using the card. Approximately 10,000 such cards have been issued.

Regular bill payments: the "additional centime on the water bill" as an example

Another form of voluntary contribution may consist in soliciting the consumer at the time of payment of a utility bill, e.g. water, electricity or telephone.

This solution could take as its example the campaign launched in the United Kingdom in 2002 by Wateraid, an NGO, in association with 10 water distribution companies. 22 million households were asked to give for development when paying their water bill.

From this experience, two observations can be drawn:

- Few people ultimately signed up. Out of 22 million households, 15,000 subscribed. About7% leave every year.

- For those who stay, Wateraid's figures show an increase in their donation: while

the average initial payment is 8 euros per month, this can rise to a monthly figure of 15 euros after a few years given proper information and reminders.

International taxation

Taxes on financial transactions

Monetary and financial assets are traded in broad, deep and liquid markets, many of which operate across the globe. The resulting volumes are substantial, even when measured against the most common macroeconomic aggregates.

National and international financial transactions (foreign exchange and securities) therefore represent an attractive and highly dynamic basis for taxation. Because these activities are highly competitive and in some cases very homogeneous, they form an exceptionally mobile tax base. Very low rates of taxation could therefore yield high revenues, provided they are levied in a relatively coordinated manner among major nations. Moreover, these taxes can help correct negative externalities if they serve to eliminate transactions deemed not useful, or indeed harmful, from the standpoint of market efficiency, notably those transactions which generate excessive price volatility.

These taxes are frequently criticized from the standpoint of their economic efficiency[40]. They raise the cost and reduce the volume of transactions; they artificially modify investors' time horizons at the expense of the short term; they reduce market liquidity and may thus indirectly contribute to increased volatility. They are by nature subject to cascade effects. Their real incidence is unknown and unpredictable, and may greatly exceed their theoretical rate. There is a high risk of double taxation (notably with regard to transactions conducted through intermediaries or collective investment vehicles).

These arguments have greatly contributed to the disfavor with which economists currently view those taxes.

However, financial assets are already subject to considerable tax distortions, notably due to the profusion of preferential regimes, the differential treatment of income and capital gains or losses, and to the difficulty of applying this treatment to derivative products (where the distinction between income and capital is blurred); in addition, there are difficulties related to

the measurement of income and stocks of assets held, along with the possibilities of evasion afforded by the increasingly international nature of markets[41].

In addition, the impact of a transaction tax on investment decisions is probably negligible, as compared to other tax measures or prudential regulations to which many financial intermediaries and institutions are submitted in their decisions on portfolio allocation.

Finally, for many assets, there are already significant transaction costs, and taxation, in comparison, would probably have only a marginal impact. This is not the case for all markets, however, and caution should be exercised in determining tax rates accordingly.

Overall, a low rate of taxation on financial transactions could prove far less distorting than a higher rate of taxation applied to other bases.

A tax on foreign exchange transactions

Foreign exchange transactions totaled USD 1,200 billion daily in 2001. The bulk of these transactions took place between the three main currencies (30% euro/dollar, 20% dollar/yen, and 11% dollar/sterling).

Foreign exchange transaction taxes have been thoroughly debated as a means to prevent speculation and stabilize exchange rates. This report takes a different approach. Such a tax is considered for the sole purpose of raising funds for development. Accordingly, the rate should be set at a very low level (around 0.01%) in order to minimize market disruption and limit the risk of evasion.

The tax is technically feasible on a global scale

The tax can be levied either at the transaction or settlement/ payment stage.

In either case, the transaction must be declared. Contrary to a common assumption, payment systems (with the exception of the Continuous Linked Settlement System or CLS, which accounts for approximately 30% of transaction volumes) are not specific to foreign exchange systems, and do not allow identification of the nature of the operations passing through them.

In order to limit the risk of evasion, the tax should be levied at the settlement stage. Settlement systems operate with very large-scale infrastructures and require a very secure legal environment. In addition, these systems require access to central bank money order to clear the balance on their transactions. For all those reasons, delocalisation to “exotic” financial centers is impossible.

It is very doubtful that such a tax can be levied on a regional basis

Even if this tax is levied at the place of settlement, there is a very high risk of delocalisation if some main financial centres do not participate. Settlement systems may then execute internal clearing transactions outside of the taxation zone and settle only the balance of net positions in central bank money.

Central banks could theoretically thwart this evasion by refusing to open accounts for settlement systems located outside the taxation zone. But that would turn the central banks into auxiliaries of the tax authorities, which is hardly their function. In addition, this would encourage banks to develop settlement systems requiring less central bank money, which would ultimately diminish the effectiveness of monetary policy[42]. Central banks could therefore be expected to put up powerful—and doubtless legitimate—resistance to such a proposal.

All market making activities should be exempted from taxation

Banks conduct two types of transactions in the markets, namely transactions on their own account, which are no different from those of other operators, and market making transactions. In the latter, they continuously swap foreign exchange positions in order to balance their net position at a level compatible with the degree of risk market makers are authorized to take (which is subject to strict supervision). These are practically zero-cost operations, with estimated daily profits of less than 0.01% of the volumes exchanged. A tax would push these activities into permanent loss, which could lead either to further concentration among a very small number of major players, or to the complete disappearance of these activities, with the market adopting a different model of centralized price quotation. In terms of market efficiency and stability, the effect is uncertain. From the point of view of the tax, a sizable fraction of the tax base would definitely disappear.

These two considerations argue in favor of exempting market making activities. There is no certainty of being able to distinguish, legally and functionally, between a market making transaction and an own-account transaction within the interbank market. Market making transactions account for the majority (59%) in volume terms. One could consider exempting all interbank transactions, though at the risk of discriminating between banks and other actors (investment funds, notably), and shrinking the taxable base still further.

A risk of over taxing certain financial instruments

Swaps and options transactions may find themselves taxed several times over.

A swap transaction combines a spot (short leg) transaction with a forward (long leg) transaction. These transactions account for nearly a third of daily foreign exchange operations. They would be taxed twice, which represents an unwarranted penalization since for the most part these are operations designed to optimize cash balances across an array of currencies.

Over-taxation would be further amplified in the case of options, even if the amounts involved are smaller (average daily transactions generate USD 60 billion in premiums). For the seller of a currency option, managing it over its lifetime implies a continuous stream of spot transactions on a fraction of the underlying amount.

Risks of technical evasion

The tax can be circumvented by:

- The use of derivative products, for example by synthetically reconstituting a spot currency position by combining a loan and two options transactions (a call and a put).
- By swapping liquid securities denominated in the two currencies, in place of the currencies themselves.

However, these operations are more expensive and riskier than the straight transaction and would probably not be worthwhile if the tax rate were set sufficiently low.

An uncertain economic impact

The tax would probably fall entirely on end-customers, i.e. corporations with international operations and fund and asset managers engaged in reallocating portfolios internationally including hedge funds, which can occasionally play an important role in foreign exchange markets. The tax may be seen as an indirect means of reaching an elastic and highly mobile base; it would also penalize international portfolio diversification, with little economic justification.

It would furthermore penalize those countries with very open markets, whose volume of foreign exchange transactions relative to GNP is fairly high.

A general tax on securities transactions

If the aim is to tax all financial transactions, totally eliminate discrimination at the expense of international flows and, more generally, minimize resulting economic distortions, it may be worthwhile examining the possibility of taxing all securities transactions in the developed countries' markets (listed shares and bonds, including government securities if appropriate):

- These are very broad, dynamic markets, although their structures vary from country

to country. Except in the United States, equity markets are organized along centralized quotation lines, whereas bonds are bought and sold over the counter through market makers[43];

- Many countries, including those where the major financial centers are located, tax security transactions, thereby raising substantial revenues. However, none of them currently taxes bond transactions. There is a trend towards a reduction in tax rates or a suppression of taxes themselves, although it is not clear whether governments are acting out of a concern for market efficiency or in response to the pressures of international competition;

- Revenues are potentially high. Daily transactions on global equity markets amount to USD 210 billion. Based on French data, the figure for bond transactions may be estimated (subject to verification) at four times that amount. Using these bases, annual revenues of USD 10 billion correspond to a (tiny) rate of 0.005% (or one half of a basis point);

- However, this rate would have to be modulated according to the nature and function of each instrument and each market. For some of these (government securities, notably), transaction costs are lower still, and taxation even at this rate would seriously penalize market liquidity. For others, a higher rate of taxation could be feasible;

- Some instruments would have to be exempted, especially those used as vehicles for monetary policy operations;

- As with foreign exchange transactions, market making activities, which take place at practically no cost, should be exempted from taxation;

- Market making activities, and more generally the transactions themselves, are very easy to delocalise, which would call for a very broad application of a tax covering all major financial centres.

There ought to be no major technical difficulty in levying such taxes. In all of the developed markets, securities are held by a limited number of custodial institutions, and settlement generally takes place through specialized systems.

Environmental taxes

General considerations

Environmental taxes are economically rational. Contrary to other taxes, they do not create additional distortions, but rather contribute to the elimination of existing ones. They act as an incentive for economic agents to adopt behaviors conducive to sustainable development by changing their consumption patterns and adapting their technologies.

To a large extent, environmental problems demand global solutions. Environmental taxes could therefore be an excellent starting point for a worldwide taxation system.

This is the rationale behind proposals for the introduction of a global tax on carbon emissions:

- Carbon emissions are the main factor responsible for the greenhouse effect which contribute to global warming. The concentration of greenhouse gases in the atmosphere has increased very rapidly since 1950 and it now exceeds the level reached at any time since the dawn of humanity. Furthermore, the surface temperature of the earth has increased over the course of the 20th century. Many of the countries, which are worst affected by this phenomenon, are among the poorest and least privileged.

- These emissions are diffuse, caused by a wide range of human activities (heating, transportation, electricity production, etc.) and affecting a great many individuals. In this situation, taxation would be the most effective instrument relative to other forms of intervention, e.g. regulatory standards.

- By nature, the greenhouse effect is a global phenomenon, and the limitations of national policies are quickly apparent.

- Finally, a global carbon tax could generate substantial revenues. If the rate were set at a level, which would fully compensate for the economic cost of the greenhouse effect (at least USD 100 per ton of carbon equivalent), this tax alone would suffice to

close the Millennium Development Goal funding gap. Even a much lower rate (around USD 10 per ton) would still make a considerable contribution of between USD 10 and 20 billion annually.

In the long term, the issue of a carbon tax will certainly take centre stage in the international taxation agenda.

The outlook is less certain for the foreseeable future, though:

- There is debate within the international community on the suitability of taxes in relation to other instruments, and in particular tradable emissions permits.
- Another approach is currently guiding international cooperation in tackling the greenhouse effect: the Kyoto protocol, which entails commitments to cap emissions backed, in some countries, by a system of tradable permits.

- A carbon tax would have major redistributive effects between activities and countries. Its introduction would therefore necessitate an international agreement on the evaluation, administration and offsetting of these effects, where appropriate. Any such agreement would presuppose a common vision of equity in the apportionment of efforts and rights, which is why reaching it would be a lengthy and difficult process. Indeed developing countries are exempted from obligations under the Kyoto protocol. It is possible, in such circumstances, that a large proportion, if not the entire proceeds of the tax would be used to compensate the “losers” in this arrangement[44].

In light of the above, one cannot expect a general carbon tax to produce a significant contribution to development funding in the short term. Even if such a tax were to be implemented, proceeds may be needed to finance actions more directly linked to the reduction of the greenhouse effect, as part of a comprehensive policy involving an array of instruments (including regulations and emissions permits).

This is not to say that international environmental taxation should be ruled out: it could play an immediate role, but one, which would be strictly confined to those areas not covered by the Kyoto protocol.

In this respect, transport deserves special consideration. Certain modes of

transportation—road and rail—pay general and specific taxes on their fuel consumption in all countries, part of which at least are specially designed to internalize negative effects on the environment; their emissions are included in the Kyoto emissions quotas. But the aviation and shipping sectors are totally exempt and unaffected by Kyoto. This exemption appears to flow from the acknowledged "international" character of these activities, which operate to a large extent in areas beyond the reach of national sovereignty. This does not mean however, that it is technically impossible to envisage some form of taxation. This deserves particularly close consideration, given that environmental damage caused by aviation and shipping is far from negligible.

Air transport

Civil aviation has experienced a long period of rapid expansion. Global traffic has grown by 8% annually since 1960, in value terms, and its volume is forecast to grow by 5% between now and 2015 (on a median assumption). The growth in intercontinental flights is especially pronounced; in recent years this growth has been concentrated primarily on the first and business class passenger segment, which represents two-thirds of airline revenues, on average.

This very positive overall trend is accompanied by sharp annual volatility in activity and profits. Since 2001, the sector has been experiencing a cyclical downturn with significantly reduced earnings; the best-performing players achieved an operating margin of less than 1% in 2003.

Yet, air transportation is the source of significant environmental damage: local pollution in the form of polluting gases and noise pollution in the vicinity of airports, and global pollution in the form of greenhouse gas emissions (chiefly carbon dioxide). These forms of pollution have a high social cost, estimated at 32 billion euros a year for the European Union alone.

Several countries have introduced low taxes, which partially compensate for local pollution. Where global pollution is concerned, however , aviation falls outside the Kyoto protocol, and indeed bilateral agreements between states on air transport explicitly prohibit the taxation of jet fuel.

In many countries this exemption extends to domestic transport as well. Incidentally, it confers a substantial competitive advantage on air transportation relative to other modes of

transportation, given the share of fuel costs in the total cost of air transport. This advantage is greater still within the European Union, where air transportation carries lower VAT rates than rail or road. The scale of these advantages has led the German rail operator to file a complaint before the European Communities' Court of First Instance against the indirect tax regime enjoyed by the airlines.

There are three possible ways to tax aviation-related pollution:

- A tax on kerosene consumed. This tax would be paid in the country of supply. There are several advantages to this approach: it hits the polluting factor directly, and the tax base is readily captured since sales of kerosene are regulated and necessarily occur within the airport precinct. However, there is an important legal obstacle, namely the bilateral agreements prohibiting this taxation. A multilateral treaty would need to be signed within the framework of the International Civil Aviation Organization (ICAO);

- Taxing the use of air corridors, using a method of calculation representative of the kerosene consumed during passage through a given corridor. This could be supplementary to the route fees, which airlines currently pay to the air space administration bodies, and could therefore be collected by the same procedure, with no particular difficulty. The charge/levy would be calculated in proportion to the aircraft's emissions.

- Finally, direct taxation of tickets, which would permit discrimination between passengers and, where appropriate, destinations, so as to avoid penalizing tourism to developing countries.

Each of these possibilities can be viewed from either a global or regional perspective, with unequal though limited possibilities of evasion in the latter case, depending on the option chosen.

Estimates of the yield of such a tax in the first two cases run at around USD 10 billion for a tax applied worldwide and internalizing roughly a third of the external cost of emissions (as a rough guide, this would add nearly 20% to the cost of kerosene). The average price of a ticket would rise by approximately 2.5% on this assumption.

In the third instance, a 5% tax on first and business class tickets would yield approximately USD 8 billion.

Airlines have little room for maneuver to reduce their fuel consumption per unit, in the short run; as a consequence, the entire burden of the tax would fall on operating costs. In the longer run, the tax would lead airlines to switch to less polluting aircraft.

Nonetheless, the current difficulties of the global airline industry may argue against creating a tax in the short term.

A tax on shipping

International shipping is the primary means of transport for world trade (80% of total trade, in real terms, uses shipping). This sector's growth is in line with the expansion of trade (+4% annually, in real terms, between 1990 and 2001, and +5% forecast for the period 2005-2010). The bulk of this traffic either originates from or is bound for OECD countries. Yet ships registered in OECD countries account for only a minority of the world's fleet (a little under a third), which has progressively become concentrated in the so-called "open shipping register" countries since the 1970s.

Pollution caused by shipping

Shipping causes two kinds of pollution, each of which could be subject to taxation for corrective purposes:

- Greenhouse gas emissions and emissions of pollutants that contribute to acid rain in the vicinity of the place of combustion. These emissions are growing at a rate comparable to the rate of growth in shipping: improved energy efficiency in ship design and propulsion systems have been offset by distortions in traffic patterns, where container ships and roll-on roll-off vessels, which cruise at faster speeds and therefore consume more fuel, form the fastest-growing segment. Even if, contrary to the aviation sector, there is no international norm (except in the European Union) to prevent such taxation , no country has undertaken taxing these emissions. Moreover, emissions produced by international shipping are excluded from the national quotas established by the Kyoto protocol;

- The spreading of pollutants in the marine environment and on the shoreline, i.e. oil spills. This concerns two segments of the shipping sector, mainly, the bulk liquid segment (for oil and hazardous chemicals), and container traffic (for industrial products dangerous to humans or the environment). 10,000 oil spills have been recorded in the past 40 years. Not all of these incidents are of equal gravity. 85% concern leaks of less than 7 tons, which do considerable damage but have little impact on opinion; they furthermore, mobilize little in the way of cleanup resources, especially when they occur in developing countries. On the other hand, a small number of large-scale spills prompt a sharp surge in awareness, leading to changes in regulations and in insurance conditions for international shipping.

   Over long periods, the frequency and scale of incidents described as “important” (i.e. spills of more than 7 tons) has tended to decline. The significant increase in traffic since the end of the 1980s has gone hand in hand with a drop in the incidence of oil spills, testifying partly at least to the efficacy of preventive measures which countries are taking. The decline should not be taken to mean that the problem is no longer a matter for concern: some 1.1 million tons of oil products have been spilled at sea since 1990. Nor have we seen the end of major spills, as witnessed by the *Erika* or *Prestige* disasters, further sharpening public sensitivity to the issue.

   This sensitivity also stems from the heavy geographic concentration of spills in a small number of crowded shipping straits. More than a quarter of the spills recorded have occurred off the coasts of Europe, with a particularly high concentration off the Atlantic coast , the English Channel and the Baltic Sea (these three areas account for 18% of the world total); approximately 10% have occurred off the coasts of Japan and in the strait between South Korea and Japan. Taking only the major oil spills, the concentration around the European littoral is greater still, with 13 of the 20 major disasters since 1960 having occurred in this region.

   The damage caused by hydrocarbon pollution varies depending on the accident and is not directly correlated to cargo size; nonetheless, it is always very extensive in the case of the largest accidents. The Exxon Valdez catastrophe caused damage worth USD 9 billion, and the Prestige nearly USD 1.1 billion.

An appropriate tax could be devised for each of these two kinds of pollution

- a tax on bunker fuel consumption is needed in order to correct the problem of greenhouse gas emissions. According to initial estimates, a 10% tax would yield around 1 billion dollars if applied worldwide. This is a good deal less than the rate necessary to internalize this pollution. A tax to achieve this goal would imply a penalizing 150% increase in fuel prices and yield an estimated USD 20 billion.

  Apart from the possibility of adjusting shipping speeds, the tax would be fully passed on to the sector's operating costs, in the short run. Given the intense competition between ship owners, this surcharge would not be fully passed on in freight rates, especially if its level were kept low. In addition, the absence of a more economical alternative to shipping for long and medium distances ought to limit the impact of the levy on volumes carried;

- To offset the risk of oil spills, a tax is needed whose level can vary according to the polluting nature of the cargo and how dangerous the vessel is (several parameters could be envisaged: obsolescence, state of repair, training of crew, etc.). Failing that, a charge could be levied whose sole purpose is to raise revenue, and could be legitimized by virtue of the negative image of this type of transport in the eyes of public opinion. In either case, the tax would be conceived as an additional contribution to the International Oil Pollution Compensation Funds (IOPC) paid by these same agents and on the same terms. The risks of evasion, if the charge were levied solely at the regional level, would be limited given the cost of the necessary transshipment operations in order to further transport products from the nearest port in a region not applying the tax to their final destination.

Possible tax mechanisms

Corrective taxes on these two sources of pollution could be administered according to one of the following mechanisms.

The tax could be levied at the end of each journey by the port authorities, which already collect various fees from ship owners for the use of docking and unloading infrastructures.

Alternatively, the tax could transit through the International Oil Pollution Compensation fund (IOPC) mechanism, established in 1971. The IOPC, the result of an international agreement between 83 nations (except the United States), is a risk-pooling mechanism to which oil

companies contribute by means of a fee proportional to the quantities of oil and gas they carry by sea; the resulting funds are used to indemnify oil spill victims. The levy rate, which is identical for all contributors, is fixed annually by the fund in light of compensation claims received ; the amounts are paid directly into the fund by the oil companies without transiting via national budgets. Similarly, compensation for oil spill damage is paid directly by the fund, and is strictly limited by a global ceiling on compensation set by the IOPC for each individual disaster.

These taxes would weigh most heavily, or exclusively, on users of shipping and may be equated to taxes on international trade; in that sense they would penalize developing countries' integration into the global trade process. Exemption mechanisms could be envisaged based on the nationality of the merchandise or on the routes taken, but this raises considerable difficulties of principle (how to define the nationality of an item of merchandise, how to handle re-exports), and controlling them would be costly .

The tax would fall predominantly on the shipping sector in the OECD countries, which has been suffering structurally due to competition from countries with less stringent registration requirements. Even if the levy fell equally on the entire world fleet, this could still amplify the transfer of registrations from the OECD countries to those countries with more advantageous tax and regulatory regimes. In that sense, the tax might clash with the goal of improving the regulation of international shipping.

An example of pricing planetary common goods: straits

In many respects, the environment is a global "common good" of all inhabitants of our planet: it is a scarce resource; consumption cannot technically be restricted. This inevitably leads to over-exploitation and overcrowding. Other common goods exist already, or potentially, for which these problems also arise. Maritime straits offer a particularly telling example.

The right of way through maritime straits under international law makes these a legal "common good," granting all commercial vessels the right of innocent passage through them regardless of flag or destination. Coastal states are entitled (under supervision of the International Maritime Organization) to regulate navigation in a strait in order to improve the flow of traffic, but they may not impede the right of passage even temporarily. They are also prohibited from charging a fee for transit through the seaway[45].

International sea traffic accounts for three quarters of world trade in terms of volume, and its smooth flow depends primarily on navigation conditions in a small number of very busy straits. These include the Strait of Dover, the world's foremost shipping channel with 82,000 movements annually (225 daily), the Strait of Malacca, near Singapore, the world's second busiest shipping channel with 75,000 movements annually (200 daily), the Sunda and Lombok Straits in the Indonesian archipelago, and the Straits of Gibraltar and Taiwan.

>From an economic standpoint, straits can also be seen as common goods as their traffic grows, to the point where some are now overcrowded. This overcrowding can create several negative consequences:

First, for coastal states it diminishes the safety of shipping and forces them to invest in larger infrastructures to control and manage shipping. In certain straits, moreover, such as those in Southeast Asia, heavy traffic and slower navigation speeds are a breeding ground for piracy.

As for the users of these straits, it lengthens transit times through the channels concerned and can lead to costly queues.

One way to manage this overcrowding would be to charge a fee on commercial vessels passing through these straits. Because the right of transit is recognized as a common good, revenues could legitimately be appropriated by the international community.

The scale of fees could be set with reference to the gain derived from passing through the strait by comparison with the use of alternative, longer shipping routes. Partial estimates have already been established for certain straits. For the Strait of Dover, for example, a levy equal to one third of the economic gain from using this channel (for longitudinal traffic only) would yield approximately USD 1.1 billion annually. For the Malacca, Lombok and Sunda Straits, which are fairly close to each other, a one-third levy for oil tanker traffic bound for Japan would yield around USD 1.2 billion annually. A fee levied on all oil traffic would yield roughly three times that figure.

Other international common goods are also potentially subject to overcrowding, such as geostationary orbits and their associated radio frequencies. With the possible exception of certain particular positions, this overcrowding does not yet appear to be sufficiently intense to warrant charging a fee for their use. However, the absence of charging can lead to the use of economically irrational criteria for allocating orbits and frequencies, hence aggravating rivalry among operators instead of helping to resolve them (see box 10)

A tax on arms sales

World arms exports total USD 50 billion annually. These exports are frequently viewed as a politically and financially destabilizing factor in developing countries; first, they fuel conflicts, civil disorder and violence and second, because they are a burden on poor countries' national budgets to the detriment of other, more productive expenditures or ones essential to development.

Most international organizations would either like to see or simply recommend cuts in developing countries' military spending. The idea of taxing arms exports with a view to discouraging this spending has frequently been suggested. A 10% tax would yield 5 billion dollars.

This calls for two comments:

- It is unquestionably desirable that "unproductive" military spending be limited and controlled. However, many developing countries have no control over their geopolitical environment. The legitimate desire to introduce greater morality must allow for these countries' equally legitimate concern for their security, even in the absence of a national arms industry of their own;

- In terms of negative externalities, the main destabilizing effect, particularly in weak or failed states, comes less from the sale of heavy equipment than from the more or less legal channels through which small arms are purchased. An international tax would unlikely affect these flows; on the contrary, it could even encourage further opacity and clandestine dealings.

It is therefore worth examining the desirable extent and scope of application of an arms tax.

Universality as a precondition

The structure of the tangible international arms trade is highly concentrated:

- On the export side, there are four major players, the United States, France, the United Kingdom, and Russia, which together accounted for more than 65% of export volumes over the period 1992–2001. Further, arms production is relatively concentrated within these countries, as witnessed by the case of the land forces weapons industries;

- On the import side, especially among developed and middle-income countries. A very high proportion of world trade takes place among developed countries. Among the remainder, ten middle-income countries accounted for 50% of imports over the period 1992–2001. Some countries are totally or partially excluded from world arms trade due either to embargos (arms export bans) or restrictive measures (recommendations against arms exports to these countries).

The scope for changing suppliers or diverting arms shipments is very high in this market structure. Consequently, it would be enough for one of the major exporters not to apply the tax for it to be robbed of its deterrent power and become totally ineffectual. It is essential, therefore, that all countries with strong arms export potential (including China, Israel and Ukraine) participate in this tax. This condition is all the more vital given that responsibility for collecting the tax would lie with the exporting governments themselves.

Taxing domestic purchases

Once it has been decided to tax a presumably reprehensible form of expenditure (military hardware), the question arises: should the tax base be confined to exports alone? In the first instance, the burden would fall particularly heavily on countries that have no national defense industry and are therefore completely dependent on imports. This discrimination may be considered unjustified with respect to countries in tense geopolitical situations or a difficult strategic environment.

It may be fairer, and consistent with the moral aim of the tax, to base it on all military equipment purchases, including internal purchases within producer countries. The corresponding tax base would be much broader, with total arms spending amounting to nearly USD 200 billion annually.

Clearly, in such a situation producer countries would essentially be "taxing themselves." However, this taxation represents a legitimate and moral basis for an additional contribution to development—at any rate at least as justifiable as asking developing countries themselves to finance this contribution.

Which equipments should be taxed?

The tax base could be confined to tangible equipment to make the taxation more easily verifiable. Indeed, certain existing multilateral frameworks could serve this purpose. The UN Register of Conventional Arms obliges states to declare their exports, imports, deliveries of weapons to armed forces, and purchases relating to national production of certain categories of conventional weapons; the Wassenaar arrangement has 33 participating countries, and since 1999, requires the reporting of certain types of weapons.

However, intangibles represent an increasingly important aspect of arms transactions, e.g. manufacturing licenses (technology transfers), provision of services (training and maintenance), equipment or services supplied at no cost (at government discretion), or offsetting arrangements. These intangibles are less easy to control and their volume is, essentially, unknown. Their inclusion in the tax base would pose serious problems of verification.

A tax surcharge on corporate profits

Objective

If preference is given to using an existing tax base, then the option of an additional tax on the profits of major international corporations should be considered. The number and size of international corporations is increasing: in 1990, there were 37,000 multinationals with 175,000 subsidiaries, while in 2003, there were 64,000 multinationals with 870,000 subsidiaries.

The profits of these international corporations depend heavily on globalization and the opening up of economies , thereby justifying their contribution to financing development. Moreover, these corporations may be presumed to be paying less tax inasmuch as they are able to optimize their tax liability through intra-group transfer pricing (depending on the source, intra-group trade accounts for 60 to 70% of world trade). In Italy, for example, while the nominal corporate tax rate is 36%, the actual tax yield on large corporations is equivalent to 11% of reported profits.

Modalities

The introduction of such a tax would require a more precise definition of an international corporation. One criterion could be the number of countries in which a corporation is present; but this carries the risk of introducing a threshold effect, which would need to be applied flexibly.

The tax would be levied exclusively on the parent company in order to avoid double taxation.

Advantages

The main advantage of a surcharge on the corporate income tax paid by large international corporations is that it would be levied on an existing tax. There are precedents for corporate income tax surcharges; they have been imposed in Germany (to pay for reunification and for the 2002 floods), and in France (in 1995, still partially applicable, and on large corporations in 1997). Further, they would not complicate the task of administering the tax.

Finally, such a tax could yield substantial revenues even at a low rate, if one considers that total annual corporate income tax revenues amount to approximately 850 billion euros.

Observations

A surcharge on the corporate income tax paid by large international corporations raises a number of questions:

- Concerning its incidence; although opinions differ, many consider that in an open economy the burden of a tax on profits would ultimately fall on wages;
- The use of existing tax bases compounds existing distortions and differences between national tax systems (the size of the corporate income tax base varies by a ratio of one to four among the major EU countries);
- If the tax is applied regionally, there is a high risk of either physical delocalisation or a delocalisation of profits.

Professor Wachtel has proposed a variant whereby a flat-rate tax would be applied in the parent company's country to a) book, b) global, and c) consolidated profits, after deduction of tax paid in the different countries.

A tax based on book profit would eliminate evasion by definition, as well as distortions caused by the different countries' tax bases. This would represent a major change, whose difficulties should not be underestimated. The proposal is tantamount to harmonizing corporate taxation, a controversial issue in Europe (see box 11).

Combating tax evasion

It is important to ensure that any new tax instruments introduced with the aim of increasing funds available for development contain no obvious loopholes that would encourage tax evasion. This affects the range of possibilities and choices. Also, if internationally coordinated instruments are put in place, it is important to ensure that they are properly administered and controlled by the countries responsible for them, so as not to drain the new contributions of their purpose.

Moreover, tax evasion particularly affects developing countries. And yet rebuilding these countries' tax bases is essential to their development. It would be logical, therefore, to step up efforts being made by these countries in this sphere (frequently with assistance from the European Union or the IMF), not as a counterpart, but as an accompaniment to new ways and means to be put in place.

In addition, tax evasion frequently involves offshore financial centres, as concealment seeks the protection of systems combining zero or low taxation with banking secrecy.

The financial sector in these countries conducts the bulk of its business with non-residents, the volume of external claims and commitments being out of all proportion to the financial intermediation needs of the domestic economy; further, most transactions made or recorded by the financial sector originate elsewhere. These characteristics are not exclusive to offshore financial centers. In particular, tax affairs are covered by banking secrecy in many countries, to varying degrees, notably in Europe (cf. Switzerland, Luxembourg, Belgium and Austria) and Asia (Singapore).

There is an international consensus in favour of combating tax evasion and lack of transparency in financial transactions. Several multilateral exercises have been carried out in this sphere (see box 12).

- The OECD exercise in tackling harmful tax competition launched in 1998. The OECD published a list of 36 jurisdictions in 2000, calling on them to commit to signing agreements to exchange tax and bank information with the OECD member states. Only 5 jurisdictions: Andorra, Liechtenstein, Liberia, Monaco and the Marshall Islands, had failed to produce a commitment to exchange information and remained uncooperative as of March 22, 2004; none of the jurisdictions that has thus far committed has yet exchanged any information; bilateral agreements are under negotiation and the deadline for exchanges on cases where there is no prima facie evidence of fraudulent intent is set for 2006;

- The OECD Financial Action Task Force on money laundering (FATF) has defined 25 criteria with respect to money laundering and in 2000, identified 23 countries that did not respect them. On January 1, 2004 the list comprised only 5 countries, namely: Guatemala, Philippines, Indonesia, Nigeria, and Myanmar;

- The G7 financial Stability Forum, comprising representatives of governments and financial regulators, has adopted a set of financial risk criteria leading to the identification of 42 offshore financial centers. Of these, 28 were classified "Group III" by virtue of their level of supervision and their legal infrastructure.

The commitment displayed, particularly by the G7 and G20 countries, is inseparable from the objective of improving development funding. While distinct, these undertakings have in common the aim of correcting the excesses or negative effects of globalization.

The difficulty lies in the fact that we are dealing here with a "weakest link"-type problem, where the outcome depends on the effort made (or accepted) by the least dynamic link in the chain, in other words, the least cooperative country. In this context, there is frequently only a very weak connection between results obtained and the scale of efforts made.

Countries engaged in this process must plan for one final option in case existing efforts fail to bear fruit. This last resort should not be an instrument of deterrence or reprisal, but should rather reflect the realization that, if the main financial centers are unwilling to play their part and shoulder their responsibilities in a globalized economy, then there would be grounds for adopting a different attitude. Alternative action could comprise a range of regulatory frameworks regarding capital flows, and adjustments to tax legislation aimed at putting pressure on transactions with these financial centers.

Another approach might be to levy a tax to internalize the effects of bank secrecy on the tax bases of the developed and developing countries. Countries that practice bank secrecy necessarily maintain financial relations with the rest of the world, thereby providing opportunities for levying a tax.

This levy could be based on monetary flows in the direction of countries that permit bank secrecy. It could even be based on the liabilities of banks in countries that do not practice bank secrecy toward the residents and banks of countries that do permit it, since in all likelihood these balances are owned or controlled by residents of countries that permit bank secrecy. The tax would necessarily have to be applied by all countries that do not practice bank secrecy.

Other instruments

Special drawing rights

Special drawing rights (SDRs) are created by means of “allocations” decided by an 85% majority. SDRs can be used for payments between Central Banks, by transfer from one account to another within the IMF’s specialized department; this makes them monetary reserve assets.

Using SDRs to fund development is an old idea. Many developing countries, especially some of the poorest, have balances of payment that are structurally in deficit, and their borrowing capacity is either limited or saturated. SDR allocations would allow them to loosen this external constraint and, all things being equal, to finance faster growth. More simply, SDRs may be seen as a “free” financial resource whose creation is controlled by the international community, a portion of which could legitimately be allocated to the poorest countries.

All proposals are based on one or the other of two mechanisms: either a special allocation reserved for developing countries, or a general allocation, with developed countries transferring all or part of their SDR allocations to developing countries. The first formula—a special allocation—would call for an amendment to the Articles of the IMF and would probably be cumbersome and complicated. Consequently attention for several years now has focused on the second mechanism—a general allocation.

There is a great deal of opposition to the idea. Some of this stems from countries traditionally unenthusiastic about SDRs, considering them—independently of how they are utilized—to be redundant or dangerous at a time when capital markets provide sufficient international liquidity (albeit not uniformly so). Others argue that the need to obtain parliamentary approval, or even ratification, represents an insurmountable obstacle.

Beyond these, two fundamental objections warrant consideration.

First of all, SDRs are not really a "free" resource. Countries pay, or receive, interest on their SDR debit or credit positions with the IMF. By transferring the SDRs eventually allocated to them, developed countries would be liable for an additional interest charge (or a revenue shortfall). If the purpose is to make interest-free loans to poor countries, it might be preferable to consider other, more suitable and more transparent, instruments and procedures.

Second, SDRs are not ideally suited to fighting poverty. They are not a budgetary resource. They cannot be used for domestic operating expenditures, those necessary for human development.

These arguments are valid, but they are surely incomplete. What poor countries need is the assurance that they will be able to satisfy their external financing requirements in normal conditions (and provided their economic policies are sound). These countries are among those most exposed to external shocks, notably by virtue of their dependence on commodities and staple products. SDRs remain an appropriate instrument for the purpose of setting up multilateral mechanisms to assist developing countries in coping with these shocks and better withstand the impact on their balance of payments. Despite these difficulties, then, it would be preferable for the international community to continue paying this instrument the attention it deserves.

a global lottery[46]

In most countries (and notably in all OECD countries except for the UK), lotteries are heavily regulated. Operators are required to hand over a substantial proportion of their revenues to the state or to causes deemed to be in the general interest, in exchange for their license to operate. In France, for example, 26% of the stakes go to the state, while in the United States 30% goes to general interest causes.

Here, the system envisaged would entail establishing a special purpose global lottery, with the portion of revenues normally going to general interest causes instead being allocated to financing official development assistance.

A variant on this proposal might be to supplement this international lottery with additional lotteries assigned to specific causes such as HIV/AIDS, education, etc., so as to align the solidarity offered as closely as possible with individual preferences.

Lotteries are subject to prior authorization, and in most countries are governed by a system of monopoly or oligopoly concessions.

A global lottery could be instituted in one of two ways:

- either by working through the established operators in each country, i.e. by organizing the global lottery as a coordination of national ones; this system corresponds to the one used recently when setting up the European lottery, which works on the “additional” principle, with pooled stakes and harmonized prizes;

- or by creating a single global operator, with each country licensing it to operate in that country. This approach however, would be more cumbersome to implement.

In addition, it would be necessary, in designing a global lottery, to allow for purchasing power differentials between countries, with resulting differences in the ticket price and of course prizes. These differentials suggest that it would more appropriate to delegate management to national lotteries.

There is little evidence, judging from past experience with lotteries, which directly support general interest causes, that announcing that part of the revenues would go to funding ODA will attract a substantial number of new players or give this lottery a substantial competitive advantage over existing ones. Hence , the relationship between yield and redistributive effect is particularly uncertain.

To begin with, surveys of people’s behaviour in different income categories vis-à-vis games of chance show that low-income groups make up a larger proportion of the lottery clientele. If the principle of a global lottery to fund development failed to alter the clientele for this kind of gambling, then—from a domestic standpoint in each country—this type of mechanism could prove to be a regressive form of ODA financing.

Moreover, from an international perspective, the current lottery market breakdown (82% in Europe and North America) suggests that the great majority of revenues from a global lottery to finance development would come from the OECD countries. Governments and general interest causes in these countries which currently benefit from these revenues might lose out, gradually being supplanted by the international lottery. Seen from this perspective, the

global lottery would merely serve as a vehicle for additional budgetary transfers to developing countries.

CONCLUSION*: The way forward*

The creation of a global tax is more a political than an economic or technical issue. Similarly, the potential obstacles are more political in nature and are on par with the revolution such a tax would create.
Globalization is not a one-way street. The spontaneous emergence of a system of negotiated and coordinated global governance is unlikely. The present favourable momentum notwithstanding, any plan for a large-scale international tax would face massive opposition. Devising a strategy for implementing a global tax mechanism therefore requires managing the constraints and opportunities of the present situation.

Certain types of global taxes, such as financial or environmental taxes, could potentially benefit vast swathes of the world population. At the same time, in certain scenarios, the costs could in large measure be borne by a small number of operators or sectors of the economy. This situation is well known to political scientists, which explains why some policies fail to materialize, even though they create a public good. The choice of tax or taxes should seek therefore to avoid too great a concentration of contributors.

A number of recommendations may help to ensure that tax proposals do not immediately become bogged down in conflicts of interest :

- A global tax should preferably be used to finance an action whose benefits will not be excessively dispersed, making it easier to mobilize beneficiaries in its favor. One suggestion might be to give priority to sections of the population that could readily identify themselves as potential beneficiaries (young people, people suffering from a disease, etc.);

- It would also be desirable to opt for a tax whose costs are widely spread, thereby mitigating as far as possible the (inevitable) opposition. This points to a broad-based tax on private individuals, businesses, etc.

Which tax should one choose? Which action should one finance? And by what mechanisms should it be administered? This three-pronged design needs to be guided by a range of considerations:

- *Maximum impact and visibility*. The action financed must be visible and effective, and rapidly so, if we want to impart credibility to broader tax projects in the medium term. Resources should be concentrated on a small number of objectives, which should be defined by indisputable, easily measured quantitative indicators.

- *Maximum legitimacy.* This principle would favour focusing on a "grande cause" that everyone would naturally recognize as legitimate, ethically indisputable and backed by very strong economic rationale.

- *Unquestionable equity.* This consideration primarily concerns the choice of an international tax. For maximum legitimacy, the tax chosen should clearly signal solidarity between North and South, between developed and developing countries, or even directly between rich and poor. Very close attention should be paid to possible unwanted redistributive side effects of the tax.

- *Absolute transparency.* This refers to the need for a mode of governance of these funds that is indisputable in the eyes of both beneficiary governments and their populations, and of observers in the international community.

- *Economic efficiency*. Given the political opposition and prejudice, whichever tax is chosen must be economically flawless, to avoid the criticism that it impedes on economic growth. With that in mind, the exercise should favour either broad-based taxes permitting a low rate and thus creating few distortions, or taxes designed to correct existing distortions[47].

Furthermore, there is a need to forge a civil and political momentum, aimed at building enduring coalitions. It is worth noting in this respect, that successful campaigns to mobilize public opinion often depend on the breadth and innovative character of the visions they project. This should serve as a reminder not to jettison major taxation ambitions in the name of short-term political realism. The best strategy is not to eschew grand visions, but rather to move toward them step by step.

1 Some studies estimate the gains to all developing countries from a halving of world trade barriers at USD 200 billion. Of this total, sub-Saharan Africa would secure a mere 2.4 billion and South Asia (excluding India) 3.3 billion. Source : African Development Bank (2002).

2 "of the 1 to 3 millions malaria related deaths every year, it is estimated that 90% occur in Sub Saharan Africa the great majority of them among children" (Sachs and al. 2004)

3 most rural households in Sub Saharan Africa have an income between 0.33 and 0.80 USD per day, do not have access to drinkable water or basic social services and illiteracy rates are very high(Sachs and al. 2004)

4 NGOs disburse annually 7 bn USD for development (including redistribution of public funds coming from national budgets). (Rogerson and al (2004)

5 See for example Evans (2002).

6 multiyear commitments are sometimes made but for never more than three years

7 The poor countries devote between 12 and 14% of their budgets to social services, which is distinctly below the 20% called for at the UN Summit on Social Development in 1995.

8 according to studies quoted by Foster and Keith (2003), less than 20% of ODA is allocated to health and education and less than 10% to basic social services.

9 A mere 27% of net ODA flows to Africa take the form of budgetary support. Source: OECD cited by Sachs et al. (2004).

10 more than 50% of poor people in Africa live in countries which have been torn by internal or international conflicts, which create significant difficulties in the normal functioning of aid processes (Foster and Keith, 2003)

11 Oral testimony to the Working Group by *Médecins sans frontières*.

12 source : Heimans (2003)

13 source : Heimans (2003)

14 according to Tirole (2003-2) : " nearly 5 millions people die every year from tuberculosis, malaria, and from AID/HIV African varieties and yet, very little effort is devoted to research on vaccines for those diseases."

15 see Bulir and Hamann (2001)

16 according to Foster and Keith (2003), "there is strong evidence that interruptions to aid flows have been very damaging to economic performance"

17 Infrastructure spending declined by 2 to 4 percentage points of GDP in the low-income countries in the 1990s. During the same period, ODA financed less than 10% of poor countries' infrastructure spending, on average.

18 see Foster and Keith (2003)

19 Micklewright, Wright (2003).

20 Sources: Mc Donnell et al, OECD (2003); CCFD "*Baromètre de la solidarité internationale des Français*" (1999) and CCFD "*Les Français face à l'enjeu de la lutte contre la faim dans le monde*" (2003).

21 Sachs (2001) points out that all US military interventions in the developing countries since 1960 have occurred in countries that had suffered a collapse of their state structures in prior years.

22 according to Rogerson and al (2004),there would be some risk in giving to much weight to "security" criteria in aid allocation : this would not necessarily coincide with the maximum impact on poverty

23 see Gillinson (2004).

24 ODA has decreased by 7% between 1990 and 2000. It would have to increase by 23 bn USD to get back to its 1990 per capita level . Foster and Keith (2003)

25 according to Tirole (2003-1) "the fight against poverty is, by itself, a global public good. However altruistic they are, countries may prefer let others produce such a good. " Looking at medical an pharmaceutical R and D, Tirole also wonders (2003-2) if " any government would be prepared to finance by itself a global public good".

26 some authors, quoted by Rogerson and al (2004), reason that, if a limited number of countries

participate to the IFF, they might have to shoulder, when reimbursements come due, a disproportionate share of the global ODA effort

27 It is clear that African countries will still need large scale transfers beyond 2015. From this point of view, Millennium Development Goals should be considered as interim targets only.

28 Sources: World Bank for education and malaria; oral testimony to the Working Group by Médecins sans frontières; and rapporteurs' estimates based on interviews for healthcare and emergency humanitarian assistance.

29 See Heller, Gupta (2002).

30 See Gordon, Hines (2002) and Tanzi (1996, 2000)

31 Rawls (1971)

32 a further step would be to explore the design and characteristics of an international tax system designed with an explicit income redistributing objective. Some economists have looked at the possibility to use/ transpose in an international setting, some results derived, for a closed economy, from the theory of optimal taxation.

In its simplest form, the theory considers a tax system with two basic components: a linear (proportional) tax on income; and lump-sum transfers to each individual household. The system is progressive, because the average tax rate increases with the level of income (although the marginal tax rate is constant). Optimality results from the government choosing the tax rate and amount of transfer so as to maximize a social welfare function, under some assumption on the income elasticity of labor supply.

Bourguignon (2002) looks at the combination of two such systems, one in each country and one for the whole world: individuals would pay a proportional tax on their income to a world authority and receive a lump-sum transfer. There is no tax competition. Bourguignon notes that:

- many characteristics of such a model can be found in the real world. Domestic systems in developed countries are reasonably close and developing countries are converging towards it. ODA commitments expressed as a % of GDP can be seen as a proportional tax on national incomes at the world level ; and, similarly, ODA is increasingly used to finance direct or indirect income support for households.
- implementation of such a system, however, would meet with two difficulties : individual incomes are not known, especially in developing country. And there is no legitimate world authority to decide upon the tax rate and the amount of lump-sum transfers.

Mirrlees (2003) imagines a global, unified and integrated tax system which he compares to national systems. He notes that inequalities between countries are wider than within countries. This means, everything else equal, that the integrated system must have a higher tax rate and a lower lump-sum transfer than national systems. Again, precise measures of individual incomes would have to be available to caliber the two parameters.

In a presentation to the group, Atkinson (2004) made a proposal which circumvents the issue of income measurement and still pursues an explicit redistributive goal. Countries could jointly (and publicly) auction, every year, a limited number of “tax permits” whose beneficiaries would be considered as having paid both their income and capital gain taxes. Proceeds would be shared between the issuing country (one third), other countries in proportion of their GDP (one third) and the financing of development (one third).

33 See Mendez (2002).

34 See Herber (1992).

35 this point is developed by Atkinson (2003-1 and 2003-2)

36 57.000 individuals in the world have a net wealth over 30 MUSD, which totals 8370 bn USD (Heimans 2003)

37 a complete description and analysis of various possible legal and financial schemes can be found in Atkinson ((2003-1 and 2003-2)

38 a point strongly developed by Atkinson (2003-1 and 2003-2)

39 For a telling yet synthetic classification see Reisen (2003) and (2004), and Clunies-Roos (2002) and (2003).

40 a critical assessment of financial transaction taxes can be found in ; for a less critical view, see

41 see Alworth (1998)

42 see BIS (2003)

43 see Amor (2002)

44 see Cooper (1999, 2001)

45 with two exceptions : Bosporus and Dardanelles (??)

46 this development mostly comes from Addison, Chowdhury (2003)

47 according to Atkinson ((2003-1 and 2003-2), an optimal scheme will have to combine several different instruments.